PART ONE

ORIGIN AND EVOLUTION OF THE ACT

The determined effort to appropriate abnormal profits for public purposes is the feature which distinguishes the financial history of the World War most strikingly from that of previous wars. The British Excess Profits Duty, if not the very first of these special profits taxes, is certainly in most respects the greatest and best of them all. It was established very early in the war, it was applied rigorously and continuously throughout the struggle and it is being heavily utilized during this period of reconstruction. Its future place in the British financial structure constitutes one of the most acute problems confronting the British Government today.

Whatever future research may reveal regarding the early precedents for this form of taxation, the evidence shows clearly that the British Duty owes its existence to no exterior influences. It was an indigenous product—a spontaneous local reaction to a set of circumstances which arose in Great Britain with the outbreak of hostilities.

Development of Demand for Profits Control

The war had scarcely begun when it became apparent that public sentiment demanded some effective type of profits control. This sentiment rested on a broad foundation which included among other elements the dissatisfaction of consumers with high prices, the conviction of the business men that the burden of the war should be borne by those making large profits and the refusal of labor to assist anybody "to make money out of the war."

The Consumers' Reaction to High Prices.—There was the general expectation, based upon experience in previous wars, that large and fortuitous gains would accrue to the benefit of the few who chanced, through no particular skill or foresight of their own, to be in a position to supply the goods brought into a sudden and large demand by the war. It was apparent almost from the very beginning that this expectation was well founded. Large profits began to be reported. The statements of many of the limited companies as they were made public showed swollen incomes. The situation was aggravated by the fact that a large proportion of

these concerns dealt in articles of common consumption, such as clothing and foodstuffs, the prices of which had increased by leaps and bounds. One case in particular which seems to have kindled the public anger was that of a flour milling concern which announced an increase of profits of about £350,000, accompanying its announcement with an apologetic statement to the effect that the gains were the result of accident rather than design. Public discussion soon became saturated with scandal about fortunes being made out of the war and the community in general, interested primarily as consumers, but also, of course, as taxpayers and as direct participants in the struggle, reacted violently against the practice which was soon christened "profiteering," especially when the field of operations was that of the necessities of life.

The Business Men's Disposition to Penalize the Profiteer.—The consumers' sentiment was supplemented by a feeling in the business community that something should be done to control profits. In the convulsion of the early months of the war, the business man who was struggling to preserve the very life of his enterprise and to find some basis for operation which would enable him to continue in business at all found little sympathy in his heart for the "profiteer" who in this difficult time was earning not only his ordinary rate of profit but also large sums in addition. The business community generally, quite conscious that great profits were being made by a fortunate few, was very willing to support a movement which proposed to weight the burden of taxation against those new and "excessive" profits. This willingness was accentuated by the knowledge that the taxes thus borne, if imposed in some other manner, would probably fall more heavily upon business generally.

The Laborers' Aversion to Profits.—Perhaps more important than either of the influences already mentioned in furthering the general movement toward profits control and certainly more influential in bringing about the particular acts passed in 1915, was labor's aversion to working for the purpose of creating war profits for any person. The collectivist, socialistic sentiment which is so strong a factor in the British labor movement was responsible for a strong antagonism to profits *as such*—distinguished from "profiteering."[1] It became evident as soon as the

[1] The following excerpt from the Parliamentary debates illustrates a reaction which appears to be typical of British labor:

"Mr. Brace asked the Government to reconsider their position upon

Government undertook to mobilize industries for war purposes that the goodwill and coöperation of labor could be obtained only at a price.[2] That price included assurances that the efforts of the workers to speed-up production would not be reflected in high profits to the owners of the plants. Thus it came about that the measures adopted were, to a large degree, concessions to the workers. There was general agreement among the persons interviewed that both the Excess Profits Duty and its forerunner, the Munitions Levy, were to be interpreted as "sops to labor."

This combination of factors made the demand for some plan of war-profits control too great to be denied, had the Government been disposed to deny it. But on the contrary the Chancellor of the Exchequer was industriously searching for sources of additional revenue and eagerly seized the opportunity to enlist this public sentiment to the support of a tax proposal which held possibilities of immense productivity.

The Munitions Levy

At the very beginning it should be pointed out that the Excess Profits Duty did not constitute the whole of the British plan for controlling profits. In fact, even though it did become ultimately the most important part of that plan, it was not even the first measure of control to be enacted into law, for the Munitions Levy had already been in force six months when the Excess Profits Duty was established. During the early years of the war there developed in England a considerable diversity of special profit-appropriating devices. For a time each of a number of bureaus and departments had its own particular brand of "private" profits tax which it felt was best adapted to its needs and which it desired to apply in place of the Excess Profits Duty. Thus it was

> the question of nationalization. Output was absolutely necessary or this country would perish as a world Power (hear, hear), but unless the Prime Minister could get the miners away from the idea that the more they produced in coal the more they were producing in profit for private enterprise he was asking for trouble in his attempt to get increased output."
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> *The Times* (London), August 19, 1919.

[2] Thus Sir A. Markham remarked in the House of Commons: "There is considerable unrest among workingmen owing to their thinking that unreasonable profits are being made. A profits tax would do more to increase production than anything else could do." 1915. Debates, 67: 629. *Cf.* also *ibid.*, 625; 74: 408.

necessary that the Duty should interact with such special devices as the plan for the control of shipping profits; the coal mines excess payments and payments under the guarantee clauses of the coal mines control agreement; the Excess Mineral Rights Duty[3] and the Munitions Levy. The most important of these was the last.

The Munitions of War Act was passed July 2, 1915. Its general purpose is explained by its full title—"An Act to make provision for furthering the efficient manufacture, transport and supply of munitions for the present War; and for purposes incidental thereto."[4] One of the "purposes incidental thereto" was to placate labor by placing limitations on the profits of munition manufacturers.[5] The Act permitted the Minister of Munitions to designate as a "controlled establishment" any concern in which munitions work was carried on in case he considered such action "expedient for the purpose of the sucessful prosecution of the war."[6] These controlled establishments, in addition to operating under special labor restrictions, were required to pay into the Exchequer "any excess of the net profits . . . over the amount divisible under this Act."[7] "The amount divisible" was, in turn, defined as "an amount exceeding by one-fifth, the standard amount of profits."[8] Finally, "the standard amount of profits" was taken to be "the average of the amount of the net profits for the two financial years of the establishment completed next before the outbreak of the war or a proportionate part thereof."[9] Consequently by designating a munitions concern as a controlled establishment the Minister of Munitions automatically limited its profits to 120 per cent of the average of its two pre-war years.[10]

[3] For the text of the statutes relating to the Excess Mineral Rights Duty *cf. infra,* Appendix, A, II.

[4] 5 and 6 Geo. 5, ch. 54. For the text of such portions of this act as have to do with the imposition of the Munitions Levy on the profits of "controlled establishments," *cf. infra,* Appendix A, I.

[5] "The House remembers the history of the Munitions Levy. It was imposed, rightly and necessarily, partly for revenue, but mainly for this reason, that you could not expect working men to do their best if they had the feeling that their work was being used to make a private profit." Speech of Bonar Law, May 2, 1917. Debates, 93: 383.

[6] 5 and 6 Geo. 5, ch. 54, sec. 4.

[7] *Ibid.,* sec. 4 (1).

[8] *Ibid.,* sec. 5 (1).

[9] *Ibid.,* sec. 5 (2).

[10] Various allowances were made under special circumstances, such, for example, as one conditioned upon increased output.

This act imposed what was, in effect, an excess profits tax of limited application based on a pre-war standard. The statute itself was very brief and general,[11] leaving the difficult problems of application to the administration.[12] The administration, instead of being intrusted to the tax authorities, was delegated to a special organization set up under the Ministry of Munitions.

Even after the Excess Profits Duty proper had been enacted, the Munitions Levy continued to be administered separately, although in 1916[13] the two taxes were synchronized by an arrangement whereby both were calculated and the higher paid. The final merging was accomplished by the Finance Act of 1917,[14] which abolished the Munitions Levy as of January 1st of that year and delegated to the Board of Inland Revenue the task of settling up the assessments. Since that date the Excess Profits Duty has applied to controlled and uncontrolled firms alike.

The underlying reason for the separate administration of the Munitions Levy before 1917 was, according to report, personal friction between members of the Government.[15] In any case the experiment proved to be an unhappy one, the chief criticisms being directed against the apparent inability to arrive at definite assessments which resulted in an overwhelming accumulation of unfinished business and almost no collections. Apparently no complete statement of the yield of the Levy has yet been made public, the collections being merged in the financial statements with those of the Excess Profits Duty. However, the Commissioners of Inland Revenue in their 1917 report announced that the net receipts from the Levy were £4,788,636 for the fiscal year[16] and in their 1918 report made the following statement:

"The total amount assessed on 'controlled' establishments (for periods in which they were controlled) in the name of Excess Profits Duty and Munitions Levy taken together was on the 31st of March, 1918, £69,000,000. The bulk of this sum has now reached the Exchequer, while the figure of the aggregate assess-

[11] *Cf. infra,* Appendix A, I.

[12] The principles which guided the administration are formulated in a series of highly important "Rules."

[13] Finance Act, 1916, sec. 48.

[14] *Ibid.,* 1917, sec. 24; *cf.* Debates, 93:383.

[15] *Cf. infra,* p. 54, footnote.

[16] Sixtieth Report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1917 (Cd. 8887), p. 5.

ment is increasing at a rapid rate."[17] Finally in his 1918 budget speech Mr. Bonar Law said that the collections from controlled firms during the preceding year had amounted to "upwards of £30,000,000."[18]

In March, 1917, it was reported that more than 7,500 establishments had been officially designated as "controlled."

The Enactment of the Excess Profits Duty

The proposal for a general excess profits tax appears to have been first broached in the House of Commons late in November, 1914, when Mr. Lloyd George was asked whether he would propose in his next budget "a special income tax . . . with the object of impounding for the benefit of the State not less than 75 per cent of the increase on all separate incomes which are larger during this time of war than they were before the war."[19] The Chancellor declined to answer. From time to time the plan was again urged in the House[20] and it is known that as early as March, 1915, the leaders of the Government were seriously discussing the project.[21] However, Lloyd George in his budget speech on May 4, 1915, went no further than to say that if the war were to last two or three years "it would be perfectly legitimate to resort to those who make exceptional incomes out of the War" to secure the necessary revenues. He remarked that "the profits in certain trades" were "certainly considerably higher . . . than . . . in time of peace." Some were making "probably huge profits," and others had "raised their income far beyond their ordinary standard."[22]

In the debate which followed Sir A. Markham made a spirited plea for the immediate enactment of a profits tax. He said in part:

"I am one who eagerly desired to hear the Chancellor say he

[17] Cd. 9151, p. 21.

[18] Debates, 105: 691.

[19] Question of Mr. Jowett. November 27, 1914. *Ibid.*, 68: 1493.

[20] *E.g.*, February 15, 1915, *ibid.*, 69: 725; June 16, 1915, *ibid.*, 72: 725; June 28, 1915, *ibid.*, 72: 1463.

[21] The Prime Minister (Mr. Asquith) conferred with Sir Algernon Firth regarding the proposal at the end of March or the beginning of April, 1915. *Cf.* Association of Chambers of Commerce. Excess-Profits Duty. Deputation from the Executive Council to the Chancellor of the Exchequer on 3rd April, 1918.

[22] Debates, 71: 996.

would put a tax upon the immense war profits that are being made from the necessaries of life, such as bread, coal, etc. . . . The neglect of the Government to tax war profits is an invitation to everybody to rob the public to the utmost. . . . If the Chancellor had stated definitely that he was going to tax all profits in excess of the average earnings over the last three years, that would at all events have given some satisfaction to the country. . . . We are entirely in the hands of the Government. All I can urge is that the Government should not rest quietly and allow people who gamble in the necessities of life to enrich themselves by war profits. . . ."[23]

On the 15th of June it was stated in the House that the obstacle to the introduction of a profits tax was the number of difficulties to be overcome in administering such a measure.[24] On the following day, however, the Government definitely announced their intention to introduce a special profits tax. The Financial Secretary to the Treasury, Mr. Montagu, spoke as follows:

"I do most heartily agree . . . that it is necessary and that it is just that we should find and find soon, a means of taxing profits made during the War. . . . I hope that at some very early date we shall be in a position to give Parliament a water-tight proposal for getting at the extra income made during the War and for taxing it substantially.

"I would suggest . . . that it is desirable that the country should know that it is our intention to do that. . . . Our delay is simply caused by our desire to make a scheme which shall be water-tight."[25]

In the reorganization of the Government which occurred in June, 1915, Lloyd George became Minister of Munitions and early in July secured his act imposing the Munitions Levy.[26] Thus it came about that the Excess Profits Duty was finally introduced by Mr. McKenna who had succeeded Lloyd George as Chancellor of the Exchequer.[27] The measure constituted one of the proposals

[23] Debates, 71: 1033-1034.

[24] *Ibid.*, 72: 635.

[25] June 16, 1915. *Ibid.*, 729.

[26] *Cf. supra*, p. 5.

[27] To Mr. McKenna belongs the credit for having assumed ministerial responsibility for the introduction of the measure. But the difficult task of developing the proposal and putting it into the form of a statute at once broadly equitable and administratively practicable fell upon the capable shoulders of Dr. J. C. Stamp, then of the Inland Revenue. In official circles

contained in his courageous "taxing budget" of September 21, 1915.[28] Its reception by the House was favorable, the principle of the tax being generally approved and the critical comments for the most part taking the form of insistence that special allowances for unusual cases be fully provided for.[29] The bill was finally enacted into law December 23, 1915.[30]

The Statute

The virtues and defects of the British Duty cannot be intelligently discussed and appraised until the main characteristics of the statute are understood. The provisions of the statute are presented with considerable fullness in the latter sections of this report,[31] but for the convenience of those who prefer to omit the details of interpretation and procedure a brief statement of the more significant features of the act as passed is given at this point, together with a chronological account of its development since 1915.

1915 Act.—With admirable draftsmanship the statute is compressed into a brief document of less than ten pages, supplemented by a schedule of five additional pages dealing with the computation of profits, the pre-war standard and invested capital.[32]

The scope of the application of the British Duty is different from that of the American law. Our 1918 law is narrow. Under it we now tax corporations alone and even exempt "personal service corporations." Our earlier excess profits tax law was all-inclusive, applying to all business enterprises whether carried on by individuals, partnerships or corporations and extending even to profits of farmers and to professional earnings. The English statute strikes a compromise between these two extremes. It applies to all trades and businesses, not merely to corporations, but it specifically excepts (1) husbandry, (2) "offices or employments" (*viz.*, salaries) and (3) professions.[33] This was the ex-

the Duty is nicknamed "Stamp's baby" and it is generally acknowledged that credit for making the tax a practical success must be given to him rather than to any other one person.

[28] Debates, 74:341.

[29] *Ibid.*, 362, 364, 368, 371, 383, 404, 408.

[30] Finance (No. 2) Act, 1915. 5 and 6 Geo. 5, chap. 89. *Cf. infra,* Appendix A, II.

[31] *Cf. infra,* pp. 27-142.

[32] For the full text, *cf. infra,* Appendix A, II.

[33] Finance (No. 2) Act, 1915, sec. 39. For a discussion of the details of the definition of "profession" *cf. infra,* p. 28.

tent of the application as defined in the original statute of 1915 and it has remained unchanged throughout the history of the tax.[34]

The Duty is a tax on profits arising during the war. It is not restricted to profits specifically occasioned by the war. No attempt is made to inquire into the causes lying behind the increase in profits and to isolate those which are due to war conditions. Early in the history of the proposal it was urged that such an attempt be made but the objections of the administrators were accepted as conclusive. The underlying assumption of the Duty is, consequently, that all increased profits during war time are *excess* profits properly subject to special taxation.

There is a general impression current in the United States (fostered and encouraged by the terminology of the Revenue Act of 1918) that the English Duty, with its pre-war standard, results in a tax on *war* profits whereas an invested capital standard results in a tax on *excess* profits. This, of course, is a misconception. Both standards result in excess profits taxes—the first taxing as excessive all increased profits during war time and the other taxing as excessive all rich profits during war time. As a matter of fact the British use both standards. They fully recognize that their Duty is not a pure war-profits tax and part of the dissatisfaction with the Duty rests upon this foundation.

As originally passed in 1915 the measure appropriated fifty per cent of the excess profits which were defined as those which, "in the given accounting period, exceeded by more than two hundred pounds the pre-war standard of profits. . . ."[35] If, however, the profits in a subsequent year fell below the pre-war standard a refund was permitted of sufficient amount to reduce the total payment to the sum which would have been paid had the assessment been made against the net profit for the entire length of time, including the several accounting periods.[36] The importance of this relief provision should be fully appreciated. From

[34] For the special application of the law to mineral rights, *cf. infra,* pp. 29-30, to coöperative societies, *cf. infra,* pp. 30-31, to controlled establishments, *cf. infra,* p. 30.

[35] Finance (No. 2) Act, 1915, sec. 38. The rates were changed several times (*cf. infra,* pp. 34-38) and the initial exemption of two hundred pounds, was later made more liberal (*cf. infra,* pp. 33-34).

[36] *Ibid.,* sec. 38 (3). *Cf. infra,* p. 46 *et seq.* The application of this provision to shipping concerns was afterwards limited. *Cf. infra,* pp. 47-48.

the very beginning the Duty applied only to those excess profits which, even when averaged up with the smaller earnings of later years of depression, continued to be excessive in amount.

The Duty is, in fact, merely a specialized form of income tax and the British naturally built their statute on the foundation of their long-established income-tax system. Their statute specifies that, in general, profits for the purposes of the Duty shall be determined "on the same principles as the profits and gains . . . are . . . determined for the purpose of the income tax."[37] Yet special modifications must be made—modifications, moreover, which are different from those made in this country—in order to fit the income into the framework of the profits tax.

In the first place the British Duty is designed to be a trading-profits tax while ours is a tax on the total income of the business. Consequently the British exclude in arriving at taxable profits for purposes of the Duty any income which the company has received from investments.[38] Thus, also, profits of the nature of appreciation of assets, except trading stock, are eliminated, except under certain specified circumstances.[39]

In the next place, the practice in Great Britain is to average business profits for a period of three years preceding in order to establish the taxable income for the current year. This system of averages was deemed unsuited to the purposes of the Excess Profits Duty and in this case profits were declared to be those actually arising during the accounting period.[40]

Again, the British system of "collection-at-source" made it necessary to allow a concern to deduct certain items upon which it prepaid the income tax and to include in its profits certain items upon which others had prepaid the income tax before transmitting them.[41]

To prevent evasion the increase of remuneration of directors and managers was restricted even though the payments were allowed for income tax purposes.[42]

[37] Finance (No. 2) Act, 1915, sec. 40 (1).

[38] For the special case of insurance companies and similar concerns, *cf. infra,* p. 42.

[39] For a full discussion of this point, *cf. infra,* p. 69 *et seq.*

[40] *Ibid.,* Fourth Schedule, Part I, rule 1. *Cf. infra,* p. 39.

[41] For details, *cf. infra,* p. 41.

[42] *Ibid.,* rule 5. *Cf. infra,* pp. 43-44.

To prevent injustice through variations in the rates of the Duty or through the inflation of profits of a particular year, the income from long-term contracts is allocated over the life of the contract having regard to the extent to which the contract was performed in the various periods and subjected to the rates in force in such periods.[43]

Finally, in addition to the provision, already alluded to, allowing rebates of Duty paid in case of subsequent years of depression, a section was included in the law which allowed this modification of profits before making the result subject to Duty at all: when the net result of the operation of business during the three years preceding the war was a loss, any part of the profits of the current accounting period which was applied to the extinction of that loss was recognized as an allowable deduction for purposes of the Excess Profits Duty.[44]

These, then, are the chief[45] modifications made in the incomes of business concerns in order to arrive at a figure suitable for use in a special profits tax. However, the rate is applied only to such portion of this as was in excess of what was considered the normal, reasonable profit of the business. This reasonable profit was determined by the device of the "pre-war standard."

The nature of the British pre-war standard is often misunderstood in the United States. In current discussion it is ordinarily spoken of as being merely an average of pre-war profits. As a matter of fact it is an alternative standard, with a choice as to whether the criterion shall be previous profits or a return on invested capital, and with the option in favor of the taxpayer rather than against him as was the case with our law as in force for the year 1918. From the time of the passage of their original statute in 1915 the British have defined their "pre-war standard" as the average of the profits of certain pre-war years (termed the "profits standard") unless it is shown to the satisfaction of the Commissioners of Inland Revenue that this is smaller than the so-called "percentage standard," determined by applying the "statutory percentage" to the amount of capital invested in the business.[46]

The selection of the years whose earnings are averaged to

[43] *Cf. infra,* pp. 40-41.

[44] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 7. *Cf. infra,* pp. 45-46.

[45] For a full treatment *cf. infra,* p. 38, *et seq.*

[46] *Ibid.,* sec. 40 (2), *cf. infra,* p. 73 *et seq.*

establish the "profits standard" is a complicated proceeding. Ordinarily the standard consists of "the average of any two of the three last pre-war trade years to be selected by the taxpayer."[47] However, when these three years were years of abnormal depression (*viz.* the average profit at least 25 per cent below the average profit of the preceding three years), the average of any four out of the preceding six last pre-war trade years may be substituted.[48] In a case of a business commenced too recently to have had three full pre-war trade years, the taxpayer was given the option of taking the average of the two last pre-war years or merely the results of the trading of the final pre-war year. If commenced too recently to have even two full pre-war years, the profits of the one pre-war year were to be used as the profits standard. In newer businesses dependence is placed entirely upon the "percentage standard."[49]

The profits standard is subject to an important modification in favor of the taxpayer when he can show that capital which was invested before the close of the pre-war period did not become remunerative (or fully remunerative) until later.[50]

When capital has been added to or withdrawn from the business during the time intervening between the end of the pre-war period and the beginning of the taxable account-period, the income of the accounting period is decreased or increased by an amount equal to the statutory percentage of the amount of capital added or withdrawn before comparison is made with the profits standard.

The "statutory rate" is applied to invested capital to establish the "percentage standard" which is utilized in certain cases in place of the "profits standard." It was originally[51] made 6 per cent in the case of a corporation and 7 per cent in the case of partnerships and individuals,[52] the difference of one per cent being intended to compensate roughly for the advantage which the corporation enjoyed by virtue of its ability to deduct from its earnings the salaries of its managers.[53]

[47] Finance (No. 2) Act, 1915, sec. 40 (2), *cf. infra,* p. 73, *et seq.*

[48] *Ibid.,* Fourth Schedule, Part II, rule 3.

[49] *Ibid.,* rule 4. For the profits standard in the case of agencies, *cf. infra,* pp. 74-75.

[50] *Ibid.,* sec. 41 (4). *Cf. infra,* p. 79.

[51] Later these rates were changed. *Cf. infra,* p. 76.

[52] *Ibid.,* sec. 40 (2).

[53] *Cf. supra,* p. 92.

The "statutory rate" is not absolutely rigid but may be said to be the minimum rate of exemption, applicable to ordinary businesses. The rate may be increased upon appeal without maximum limit, and instances are recorded where the total rate allowed is as high as 29½ per cent.[54]

Applications for increases in the statutory percentage are entertained only when made in behalf of a "class of trade or business."[55] When the Commissioners receive such an application they must ordinarily[56] lay it before the Board of Referees. Such applications are made with great freedom and increases are granted in a large proportion of cases.[57]

The use of this percentage standard involves, of course, the calculation of invested capital, the task which occasions such great difficulty in this country. The standard is established by applying the statutory percentage to "the capital of the trade or business as existing at the end of the last pre-war trade year."[58] When there has been an increase or decrease in the invested capital since that date, an adjustment is made in the profits of the current year, the pre-war standard being suffered to remain undisturbed.[59] This has the important administrative advantage of confining the successive annual discussions with the taxpayer to questions regarding recent adjustments in invested capital.

The British definition of invested capital includes:

(1) Money;

(2) Assets acquired by purchase valued at the purchase price but minus (a) deductions for wear and tear or replacement, and (b) deductions for unpaid purchase money;

(3) Assets in the form of debts due to the business, appraised, as for income tax purposes, at their probable present worth and

(4) Assets not acquired by purchase appraised at their value when acquired subject to the usual deductions for wear and tear, etc.

The statute further states positively that any capital, the income on which is not subject to the Duty, and borrowed money shall be excluded. Moreover in appraising assets in class 4 above,

[54] Gold mining in Egypt when carried on by a partnership. *Cf. infra,* p. 134.

[55] Finance (No. 2) Act, 1915, sec. 42.

[56] For details, *cf. infra,* p. 125.

[57] *Cf. infra,* p. 121 *et seq.*

[58] *Ibid.,* sec. 40 (2).

[59] *Ibid.,* sec. 41. *Cf. infra,* p. 78 *et seq.*

"the value of the consideration at the time the asset was acquired" is the standard prescribed, with one exception, designed to prevent evasion through resort to incorporation. This exception is that in the case of a business which is converted into a company whose shares are wholly or mainly held by the former owner of the business, "no value shall be attached to those shares so far as they are represented by goodwill or otherwise than by material assets of the company."[60]

It will be observed that the British concept of invested capital, like our own, excludes unrealized appreciations. The starting point with them is the original value of the asset invested in the enterprise from which value they make deductions for losses and wear and tear and to which value they, in effect, make additions for increases and decreases in capital invested. The operation is concerned with the asset side of the balance sheet. We on the other hand deal primarily with the liability side of the balance sheet, making various alterations necessary as a result of a scrutiny of the assets. We begin with the outstanding capital stock and in so far as it represents cash or assets[61] actually put into the enterprise it is accepted as invested capital. Moreover this sum is not reduced because of subsequent losses suffered by the concern. It is a minimum which is irreducible for such reasons, representing the capital which has been "sunk" in the enterprise and a return must be earned upon it before there are any excess profits subject to tax. For example, if A invests $100,000 in a corporation in 1900, receiving therefor $100,000 in capital stock of the corporation, and the corporation proceeds to lose $50,000 in the course of trading during the next twenty years so that the real worth of the assets in 1920, is only $50,000, we would give the corporation an invested capital standard of $100,000 for the year 1920. In England the figure would be at $50,000.[62]

This fundamental difference extends moreover into the field of depreciation. Suppose, in the case cited above, that $50,000 of the $100,000 received for the stock was immediately invested in machinery with a life of 20 years, and that $2,500 was annually

[60] Finance (No. 2) Act 1915, Fourth Schedule, Part III. For qualifications and details, *cf. infra,* p. 90. Especially note *ibid.,* 1915, Part II, rule 6 and *ibid.,* 1916, sec. 47c. *Cf. infra,* Appendix A, II and Appendix A, III.

[61] With certain limitations. *Cf. infra,* p. 83.

[62] For a modification of this rule in so far as it affects certain losses during the pre-war period, *cf. ibid.,* 1917, sec. 26 (6), *infra,* p. 89.

put in reserve for depreciation. In 1920 this reserve would consequently amount to $50,000. In this country we, of course, do not permit the addition of this $50,000 reserve to the $100,000 original investment, and give the corporation an invested capital of $150,000. What we do allow is the $100,000 originally put in and we continue to allow that amount whether or not any depreciation deductions are made, whether the reserve which may be built up from such deductions is invested within or outside the business or whether it is lost through unwise investment or use. We even permit an increase in invested capital equal to any excessive depreciation deducted or for any realized appreciations in the value of invested reserves. A similar corporation in England, on the other hand, in 1920, when the machinery is scrapped, would receive no credit at all for it as invested capital except such part of the depreciation reserve of $50,000 as had been actually reinvested in the business. During the course of the depreciation of the machinery its value for invested capital would be the original cost minus "proper deductions" for depreciation plus the depreciation reserves reinvested in the business.

As a consequence the British concept of invested capital tends to be more a "current capital" concept than ours.[63] Although neither they nor we reappraise assets periodically during their life, they tend to approach more closely the value of the assets actually at work during the current accounting period.

This distinction must not be overemphasized, however. In fact the number of American corporations which benefit by virtue of it is undoubtedly small. In the absence of full allowances for net losses from period to period such relief is probably justified.

The assessment is vested in the Commissioners of Inland Revenue to whom the Act gives broad power of adjustment in particular cases.[64] A taxpayer may apply to them for modification of any of the provisions which specify the details as to the calculation of

[63] Professor Plehn in his article entitled "War Profits and Excess-Profits Taxes" in the *American Economic Review* for June, 1920 (pp. 283-298) appears to have been led astray by the fact that the English percentage standard is established by applying the statutory percentage to the invested capital as it stood at the end of the last pre-war year. As a matter of fact the modifications permitted because of increases or decreases in invested capital after that date take into account with absolute exactness the subsequent variations in capital even though those modifications are made in the profits of the current year rather than in the invested capital itself.

[64] Finance (No. 2) Act, 1915, sec. 40 (3).

profits, the establishment of the standard or the determination of invested capital when he feels that such modifications should be made in his case "owing to a change in the constitution of a partnership, or to the postponement or suspension, as a consequence of the present war, of renewals or repairs, or to the exceptional depreciation or obsolescence of assets employed in the trade or business due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war or to any other special circumstances specified in regulations made by the Treasury." There is an appeal from the decision of the Commissioners to the Board of Referees on questions included within the scope of the above section and an appeal to the regular, income-tax, appeal bodies, the general Commissioners and the special Commissioners, on other questions.[65]

Payment may be made by instalments at the discretion of the Commissioners, but a two-months notice must be given the taxpayer.[66]

1916 Amendments.—In his second budget speech, April 4, 1916, Mr. McKenna reported that, because of the delay in passing the measure, only £140,000 had been collected in place of the anticipated £6,000,000.[67] He asked that the rate be increased to 60 per cent, which he estimated would result in a yield for the year 1916-17 of £86,000,000. He pointed out to those who felt that the rate should be still higher, that, in one illustrative case, the 60 per cent rate, combined with the suggested new charge for Income Tax and Supertax would absorb no less than 77 per cent of such profits as would be classified as excessive under the British statutory provisions. The new rate was readily accepted by the House.[68]

Aside from the increase in the rate the most important change in the law in 1916 had to do with the establishment of a new arrangement whereby the profits from the sale of ships were subjected to special treatment.[69] There were also provisions which

[65] Finance (No. 2) Act, 1915, sec. 45 (5).
[66] *Ibid.*, sec. 45 (1).
[67] Debates 81: 1049.
[68] Finance Act, 1916, sec. 45 (2).
[69] *Ibid.*, sec. 47. *Cf. infra*, p. 80.

articulated the Excess Profits Duty with the Munitions Levy[70] and accomplished various minor alterations.[71]

1917 Amendments.—By the spring of 1917, Mr. Bonar Law, who had become Chancellor of the Exchequer, was able to report that the Excess Profits Duty had begun to play a leading rôle in financing the war. In the year 1916-17 it had produced no less than £139,920,000, which was £53,920,000 more than the estimate and nearly one fourth of the total revenue.[72] Not content, however, he called for a still greater contribution from this source during the year to come. He asked that the rate be increased from 60 per cent to 80 per cent which would result in an estimated increase of £20,000,000 in the yield.[73] The proposal was greeted by cheers in the House of Commons.[74] Mr. McKenna, however, sounded a warning note when he expressed some doubt as to whether, with an 80 per cent rate, coupled with income tax and supertax, enough would be left to provide a proper incentive to business.[75] The 80 per cent rate was made to apply to profits arising after January 1, 1917 and with this step the high-water-mark in the rates was reached.[76] The writer was informed that the sentiment in favor of still higher taxation of excess-profits was very strong and that a promise was even given at the time of a reorganization of the Government that the rate of the Duty would be pushed to the limit of 100 per cent.[77] It is said that only the most vehement protests from the administrative officials prevented the Government from fulfilling this pledge. The officials insisted that with a rate of 100 per cent the entire plan would collapse and urged 60 per cent, or, at the very most, 70 per cent, as the highest practical rate. Subsequent events substantiated the wisdom of

[70] Finance Act, 1916, sec. 48. *Cf. infra,* p. 30.

[71] *Ibid.,* sec. 49-57. For changes with reference to directors' fees, *cf. infra,* pp. 43-44; profits applied to previous losses, p. 46; provision regarding accounting period, p. 38; accumulating profits declared not to be invested capital, p. 84; deductibility of Munitions exchequer payments from income, p. 44; appeals in case of controlled establishments, p. 118, and exemption of bankrupt concerns, p. 29.

[72] Debates, 93: 373.

[73] *Ibid.,* 388.

[74] *Ibid.,* 382.

[75] *Ibid.,* 397.

[76] Finance Act, 1917, sec. 20.

[77] It is apparent from the debate in the House of Commons on April 4, 1916 that Sir A. Markham had some time before suggested a 100 per cent rate. Debates, 81: 1103.

this view for most of the abuses which later arose appear to be traceable to the extremely high rate established in 1917.[78]

The establishment of the 80 per cent rate was accompanied by the introduction of a notable series of relief provisions which mitigated the force of the heavy rate. First, the initial exemption was increased in the case of small concerns with a small pre-war standard.[79] Again, one per cent was added to the statutory percentage of unincorporated concerns and three per cent was added to the percentages as they stood after this increase in the case of all concerns when the percentage was used for the purpose of establishing the allowance for increased capital or for newly established businesses.[80] This limited increase in the statutory percentage was made, according to Mr. Bonar Law, upon the advice of the Board of Referees and in recognition of the increase in the cost of money since the War.[81] Moreover, special provisions granted relief in certain cases in which loss had been suffered during the pre-war period, one provision permitting the Commissioners to ignore the loss in the case of certain concerns using the profits standard[82] and another permitting them to restore to invested capital, in the case of concerns using the percentage standard, former assets which had ceased to form a part of the business or increases in borrowed money due to trading losses in the six pre-war years.[83] Finally the number of pre-war years during which capital might have been introduced into the business and yet form a basis for adjustment on grounds of being temporarily unremunerative was increased from three to six.[84]

About this time the business of shipping, which had been exceedingly profitable, was brought under control by a process of requisition and prescribed rates, 90 per cent of all ships of 1600 tons and upwards having been appropriated by the Government in this fashion on the date of the Chancellor's speech.[85] The rates were fixed at a point which was expected to yield low returns and the Chancellor was eager to prevent the owners from increasing that return through the medium of repayments of Excess Profits

[78] *Cf. infra,* pp. 149-152.
[79] Finance Act, 1917, sec. 26 (4), *cf. infra,* p. 33 *et seq.*
[80] *Ibid.,* sec. 26 (1, 2 and 3). *Cf. infra,* p. 91 *et seq.*
[81] Debates, 93:384, 436.
[82] Finance Act, 1917, sec. 26 (5). *Cf. infra,* p. 75 *et seq.*
[83] *Ibid.,* sec. 26 (6). *Cf. infra,* p. 89.
[84] *Ibid.,* sec. 26 (7). *Cf. infra,* p. 79.
[85] May 2, 1917. Debates, 93:386.

Duty already collected on the high earnings of the preceding two years. This repayment would automatically result through the operation of the section of the law requiring the Inland Revenue to make a readjustment of the duty paid in a year when excess-profits were earned whenever in subsequent years the profits fell below the pre-war standard. Consequently the relief section was almost entirely suspended so far as shipping profits were concerned.[86]

Other sections of the Finance Act of 1917 provided relief to those who were subject to both the British and Colonial excess-profits taxes,[87] abolished the Munitions Levy and transferred the unfinished business connected with it to the Inland Revenue;[88] permitted the reopening of cases before the Board of Referees under certain restrictions;[89] declared war bonds acceptable in payment of Excess Profits Duty;[90] and established an alternative method of taxing coöperative societies.[91]

1918 Amendments.—The financial results of the 1917 changes were very satisfactory. Whereas an increase of £20,000,000 had been expected from the higher rates, an increase of £40,000,000[92] was actually realized, making the total receipts for the year from this source £220,214,000.[93] For 1918-1919, Mr. Bonar Law estimated that the collections would be £300,000,000 without any further increase in the rate. Such an increase had been urged[94] but the result of such action would, he thought, bring less revenue rather than more.[95] He, therefore, contented himself with suggesting one major amendment to the law—that which subjected to taxation profits arising from the sale of trading stocks, the rate remaining the same.

This amendment, however, marked a fundamental departure from the ordinary British concept of income. As has been pointed out,[96] capital gains are not ordinarily included within the scope

[86] Finance Act, 1917, sec. 22. *Cf. infra,* pp. 47-48.
[87] *Ibid.,* sec. 23. *Cf. infra,* p. 32.
[88] *Ibid.,* sec. 24. *Cf. infra,* p. 7 *et seq.*
[89] *Ibid.,* sec. 25. *Cf. infra,* p. 126.
[90] *Ibid.,* sec. 34. *Cf. infra,* pp. 111-112.
[91] *Ibid., sec.* 26 (8). *Cf. infra,* p. 31.
[92] Debates, 105:699.
[93] Financial Statement, 1918-1919, p. 5.
[94] *Cf.* Debates, 105:752.
[95] *Ibid.,* 704.
[96] *Cf. supra,* p. 12 and *infra,* p. 69 *et seq.*

of the Income Tax or the Excess Profits Duty. It was found, however, that the Duty was being evaded through the device of disposing of trading stocks in bulk or as a part of the assets of the business when it was sold as a going concern.[97] Public attention has been drawn particularly to the loss of duty which had resulted from certain transactions in large stocks of whiskey in Scotland. The amendment was aimed to stop such leaks and provided that "profits arising from the sale . . . otherwise than in the ordinary course of trade of the trading stock . . . belonging to any trade or business shall be deemed to be profits arising from a trade or business."[98] It will be noted that this section is after all, of fairly narrow application, affecting, as it does, merely stock in trade. Sales of any other type of asset are still considered capital transactions and lie outside the scope of the Duty.

The Finance Act of 1918 also provides for an appeal to the Board of Referees in certain cases of dissatisfaction with rates of depreciation[99] and defines the extent of obsolescence deductions.[100]

1919 Amendments.—The receipts from the Duty in 1918-19 fell short of the budget estimate of £300,000,000 by £14,972,000.[101] During this year the Duty alone was responsible for nearly one-third (32.1 per cent) of the total receipts of the Government. The war was now over and the Chancellor felt justified in recommending the reduction in the rate of the Duty from 80 per cent to 40 per cent. Notwithstanding this decrease, the total receipts for the following year were again estimated at £300,000,000, the arrears being large[102] and the 80 per cent rate still applying to portions of accounting periods subject to assessment during 1919. No changes of importance other than the reduction in the rate were made in the statute this year.[103]

97 Debates, 105: 704.

98 Finance Act, 1918, sec. 35 (1). For details *cf. infra,* p. 70 *et seq.* Cases where stocks are disposed of otherwise than by sale, *e.g.* by distribution *in kind,* are adequately covered. Sec. 35 (4). Excess Profits Duty charged upon such profits were declared not to be deductible for purposes of Income Tax. Sec. 31.

99 *Ibid.,* sec. 24 (1).

100 *Ibid.,* sec. 24 (3). *Cf.* also sec. 24 (4) relating to deductions on account of annual value of premises.

101 Financial Statement, 1919-1920, pp. 3, 5.

102 *Cf. infra,* p. 115.

103 For clarifying amendment regarding colonial double taxation, *cf.* Finance Act, 1918, sec. 34, *infra,* Appendix A, V.

1920 Budget Proposals

The yield of the Duty in 1919-20 closely approximated the estimate, amounting in all to £290,045,000.[104] The general expectation was that the tax would be completely abandoned at this date but the Chancellor, Mr. Austen Chamberlain, surprised the country by asking for its continuance for another year and at the increased rate of 60 per cent. £220,000,000 was the budget estimate for the yield of the Duty in 1920-21, in case the rate were increased as suggested.[105] The problem of the future of the tax is discussed elsewhere[106] but at the date of writing[107] the 60 per cent proposal apparently is certain of adoption, the levy on capital which was suggested as an alternative for the increase in the rate having been definitely discarded by the Government. In addition to the increased Excess Profits Duty, the Chancellor proposed a five per cent tax on the profits of corporations. No other amendments or changes are proposed in the Finance Bill as introduced, but during the debates amendments were proposed increasing the statutory percentage applying to new capital from 9 and 11 per cent to 10 and 12 per cent and raising the figures for relief to small businesses from £2000 to £4000.

Summary

The Excess Profits Duty, passed December 23, 1915, as well as its companion measure, the Munitions Levy, passed July 2, 1915, were to a large extent concessions to labor in order to win its support to a program of large production during the war. The measure, however, enlisted public support generally on a variety of grounds so that the demand for its enactment was irresistible.

The Duty was levied on all business profits in excess of a standard which might be either an average of pre-war profits or a percentage of capital invested, whichever favored the taxpayer. The rate has varied, beginning at 50 per cent, rising as high as 80 per cent, dropping back to 40 per cent and, finally, rising once more to 60 per cent.

Aside from these variations in the rates, however, there have been no changes in the statute of fundamental importance. The same principles have held throughout and the amendments have

104 Financial Statement, 1920-21, p. 6.

105 Speech on making the Financial Statement, April 19, 1920, p. 15.

106 *Cf. infra,* p. 161 *et seq.*

107 July 12, 1920.

for the most part affected only details. While we in America used one invested capital standard in 1917, adopted an alternative profits or invested capital standard for 1918 and abandoned the profits standard in 1919, the British have held to their original arrangement, the only important modification being a change of percentages used in establishing the standard based on invested capital. While we changed the application of our statute from extreme broadness to extreme narrowness, the application of the British Duty has remained the same. While we have made sweeping changes in our definition of taxable profits and invested capital, the British have made only minor alterations. This stability has undoubtedly been a factor in the success of the British administration.

In comparison with the American law, the most impressive features of the British statute, aside from its comparative stability, are the remarkable care which is taken to alleviate cases of unusual hardship, the wide scope given to the administrative authorities in making adjustments and the full provision made for appeals to bodies outside the courts of law. These features are fully discussed in later sections.[108]

[108] *Cf. infra,* p. 27 *et seq.* For summary *cf.* p. 139 *et seq.*

PART TWO

INTERPRETATION AND PROCEDURE

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INTERPRETATION AND PROCEDURE

Part One of this report[1] describes the development of the statute in broad outline and traces the changes made during the years of operation. The part which follows attempts a more detailed exposition of certain specific topics concerned with the interpretation of the law and its administration. The topics selected for this more ample treatment either contribute to an understanding of the general procedure, or offer suggestions for improvement in our practice.

Although cross-references have been used very freely, it has not been possible to avoid some minor repetitions both as between Part One and this part and as between different topics treated in this part; but as the chief value of this section of the report will be for purposes of reference to specific topics, it is believed that such repetition as exists will prove to be an advantage rather than a disadvantage. The reader who is interested merely in the general aspects of the Duty may well omit Part Two entirely.

Application

Scope of Application.—The British statute applies to "all trades or businesses (whether continuously carried on or not) of any description carried on in the United Kingdom, or owned or carried on in any other place by persons ordinarily resident in the United Kingdom, excepting—

(a) husbandry in the United Kingdom;
(b) offices or employments;
(c) any profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on and in which no capital expenditure is required, or only capital expenditure of a comparatively small amount,

but including the business of any person taking commissions in respect of any transactions or services rendered, and of any agent of any description (not being a commercial traveller, or an agent whose remuneration consists wholly of a fixed and definite sum

[1] *Supra,* pp. 3-24.

not depending on the amount of business done or any other contingency)."[2]

The Duty, consequently, while broader in its scope than our present Excess Profits Tax, is more narrow than our 1917 law in that it excludes farmers and professional men.[3] It taxes both corporate and non-corporate business, both private and municipal trading ventures and even coöperative societies. Salaries, professional fees and farmer's profits lie outside its scope.

The application of the Excess Profits Duty is broader than that of Schedule D of the British Income Tax in that the term business is interpreted to include transitory businesses which cannot be said to have *annual* profits.

Husbandry is interpreted to include market gardening and nurserymen, but not cattle dealers, milk sellers or seedsmen.

The line between businesses and professions is found to be difficult to draw. The term *profession*, of course, includes barristers, solicitors, doctors, architects and accountants. But there are many border-line cases. The element of personal qualification is of great importance, the general tendency being to restrict the term to those callings which apply tests for admission into their ranks. Photographers, horse trainers, and producing actors have been ruled out but consulting engineers (not engineering businesses) are included within the definition of professions.

There has not been entire satisfaction with the scope of the Duty. Not only has the attempt to draw a precise line between professions and businesses given rise to difficult cases, but there has been a feeling in some quarters that the whole policy of ex-

[2] Finance (No. 2) Act, 1915, sec. 39.

[3] Although professional men were taxable under our 1917 law, the rate was fixed, by sec. 209, at 8 per cent on the net income over $6000, of any trade or business in which no invested capital or merely a nominal capital was employed by an individual or a partnership. In the case of corporations the exemption was $3000, the rate the same. Our Treasury Department has attempted to exclude as many taxpayers as possible from the benefit of this low rate, adopting in some instances rather far-fetched arguments of capital being employed indirectly (as by enjoyment of credit due to the financial responsibility of the stockholders of a corporation or the members of a partnership). In many such cases the result has been to exclude the taxpayer from sec. 209 of our 1917 law and yet leave him with practically no invested capital and subject to an inordinately high tax—in which cases the tax has often been substantially reduced by granting him "constructive invested capital" under sec. 210 of the law and the regulations adopted to carry that section into effect.

cluding professional earnings was a mistaken one. The many cases of doctors and lawyers who remained at home and increased their incomes above pre-war levels partly because of the absence of their colleagues aroused some indignation.[4] There were others who felt that the exemption of husbandry, which was based purely on administrative grounds,[5] was unjustifiable, particularly in view of the comparatively large profits of this class during the war and their presumably favorable position under the income tax.[6] The inclusion of the coöperative societies within the application of the Duty, when they were exempted from income tax, caused some complaint and furnished the basis for a plan for their special treatment.[7] On the whole, however, the manner in which the application of the act was delimited must be said to have met general approval.[8]

Excess Mineral Rights.—Special provisions of the statute govern its application to certain increases in payments received for the right to work minerals. This Excess Mineral Rights Duty, as it is called, is very much restricted in its application. It is levied only "where the amount payable to any person as rent in respect of the right to work minerals or of any mineral wayleaves (in cases where the right to work the minerals and the mineral wayleaves are not part of the assets of any trade or business)[9] varies according to the price of the minerals, and the amount so payable in respect of any working year ending on any date after the commencement of the present war . . . exceeds the pre-war standard of that rent."[10] The rate is the same as the Excess Profits Duty proper.[11] The pre-war standard is "the

[4] Debates, 93:414; 105:770. Deputation from the Executive Council of the Association of Chambers of Commerce of the United Kingdom to the Chancellor of the Exchequer, April 3, 1918, p. 18.

[5] An official of the Inland Revenue stated bluntly that the Duty from the farmers would not have been worth the labor necessary to gather it.

[6] *Cf.* Debates, 93:388; 105:770.

[7] *Ibid.*, 93:421. *Cf. infra,* p. 30. *Cf.* Deputation from the Association of Chambers of Commerce of the United Kingdom, April 24, 1917, p. 11.

[8] Bankrupt concerns were specifically exempted in 1916 (Finance Act, sec. 56) so long as carried on under the court.

[9] This phrase refers only to the assets of the trade or business of the person receiving the rent for the right to work the minerals. Finance Act, 1916, sec. 46 (2).

[10] Finance (No. 2) Act, 1915, sec. 43 (1).

[11] *Ibid.;* Finance Act, 1916, sec. 46; *Ibid.,* 1917, sec. 21; *Ibid.,* 1919, sec. 33; Finance Bill, 1920.

average of any two of the three last pre-war rent values, to be selected by the taxpayer."[12] For further details the reader is referred to the statute itself.[13]

Controlled Establishments.—As has been shown,[14] certain concerns were subjected to a law imposing a Munitions Levy even before the Excess Profits Duty was established. The original excess profits statute of 1915 was couched in general inclusive terms which brought within its scope all establishments described irrespective of whether they were "controlled" or not. The adjustment was left until 1916, the Finance Act of that year specifying that sums actually paid under the Munitions Levy "which appear to the Commissioners to be attributable to the same period and subject matter as that for which Excess Profits Duty is to be paid" might be accepted as payment of the profits tax.[15] Excess Profits Duty payments, on the other hand, could be used to cancel Munition Levy payments. Consequently the charge which applied against the business was either the Munitions Levy or the Excess Profits Duty, whichever was higher. Later the Munitions Levy was abandoned and the concerns brought under the Excess Profits Duty. The Commissioners of Inland Revenue were given the administrative task of winding up the old assessments.[16]

Trading Ventures of Local Authorities.—The British apply the Excess Profits Duty to the results of any industrial or trading ventures undertaken by local governmental authorities. Each venture is separately assessed and each has its own standard, but there is a saving provision to the effect that if the net result of all of the ventures is such that there is a burden upon the local tax rates with respect to them, even for sinking-fund purposes, no Duty shall be charged.[17]

Coöperative Societies.—Although exempt from income tax (on the theory that the members have incomes too small to be subject to tax so that anything collected under Schedule D would have to be repaid), coöperative societies were nevertheless subjected to the Excess Profits Duty on the theory that it is a charge upon

[12] Finance (No. 2) Act, 1915, sec. 43 (2).

[13] *Infra,* Appendix A, II.

[14] *Cf. supra,* p. 5 *et seq.*

[15] Finance Act, 1916, sec. 48. *Cf.* Mr. McKenna's exposition. Debates, 81: 1052.

[16] *Cf. supra,* p. 7.

[17] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 9.

the profits of the enterprise as such, rather than upon the resources of the individual members.[18] In recognition of the peculiarities of these societies, however, special methods of calculating the Duty were provided.[19]

Agents of Foreign Businesses.—The knotty problem of how to arrive at the profits of a selling agency of a foreign business concern is attacked in a section of the Finance Act of 1918.[20] As drawn, it is, strictly speaking, an income tax provision, but it is one which applies to the calculation of profits for the purposes of the Excess Profits Duty as well. The statute provides that "where a non-resident person is chargeable to income tax in the name of any branch, manager, agent, factor, or receiver, in respect of any profits or gains arising from the sale of goods or produce manufactured or produced outside of the United Kingdom by the non-resident person, the person in whose name the non-resident person is so chargeable, may . . . apply . . . to have the assessment . . . made or amended on the basis of the profits which might reasonably be expected to have been earned by a merchant or, where the goods are retailed by or on behalf of the manufacturer or producer, by a retailer of the goods sold who had bought from the manufacturer or producer direct, and, upon proof . . . of the amount of the profits on the basis aforesaid, the assessment shall be made or amended accordingly."

For example, an American corporation manufacturing in the United States but selling all its product in England, is taxed in England on the selling profit only. Under our law a British Corporation manufacturing in England and selling all its product here would be taxed on all its profit both from the manufacturing and the selling activities, apparently on the theory that the entire net income of the corporation is from "sources within the United States."[21]

[18] Objection to the taxation of these societies was made in the House of Commons by Mr. Clynes, who insisted that it amounted to a tax on workmen. Debates, 93:421.

[19] For details, *cf.* Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 10, *infra,* Appendix A, II; Finance Act, 1917, sec. 26 (8), *infra,* Appendix A, IV.

[20] Sec. 25.

[21] The statute taxes foreign corporations on "income from sources within the United States . . . including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States." Revenue Act of 1918, sec. 233.

Colonial Double Taxation.—Serious difficulties early developed in cases where the same income was chargeable to the excess profits tax of some other country as well as to the British Duty. An arrangement was entered into with New Zealand under which only the higher of the two taxes was imposed and the proceeds allocated between the governments.[22] In the Finance Act of 1917 this procedure was made available, through an Order in Council, to "all His Majesty's possessions."[23]

The extent to which residents of Great Britain shall be relieved of British taxes on both income and profits because of taxes paid in other jurisdictions, either foreign countries or dominions of the British Empire, is a question which has recently aroused much public discussion in England. The Association of Chambers of Commerce of the United Kingdom adopted a resolution in 1919[24] which urged that reciprocal arrangements be made with both the Dominions and the Allies. The text of the resolution read as follows: "That the present system of duplicate payment of taxes on profit of businesses and on incomes of individuals levied by this country, our Dominions and our Allies is unjust and that His Majesty's Government be urged to make arrangements with the Governments of our Dominions and Allies to avoid the duplicate payment of such taxes."

Thus far, however, the British Government has not been willing to go beyond the arrangement described above which is limited to "His Majesty's possessions." Profits taxes paid elsewhere are deductible, it is true, in arriving at taxable profits[25] but the amount of such taxes is not set off against the amount of the Duty payable in England. Our practice which virtually permits an American taxpayer to present a foreign tax receipt in payment of his domestic tax obligation is considered unduly liberal in Great Britain.

The general philosophy lying back of the British practice on this point is plainly stated in the Report[26] of the Royal Commis-

[22] Debates, 93: 435.

[23] Finance Act, 1917, sec. 23. This phrase was later defined to include all territory under His Majesty's protection. Finance Act, 1917, sec. 34. The relief was not to be less than that afforded under other sections of the Act.

[24] Annual Meeting, April 15-16, 1919, p. 159. *Cf.*, also, Deputation from this Association to the Chancellor of the Exchequer, June 15, 1917, pp. 66-7.

[25] *Cf. infra,* pp. 44-45.

[26] Cmd. 615, p. 18 *et seq.*

sion on the Income Tax, just published. It is the conception of the British Empire as an economic entity within which capital should flow freely from point to point and from which capital should not venture forth except when offered a return after foreign taxes have been paid at least equal to that which might have been earned had the capital been used within the Empire.

The theory of our law is that an American company with a foreign branch should not pay more in total taxes than a precisely similar American company without a foreign branch. Consequently we say, in effect, "Pay whatever profits taxes the foreign country demands and we shall accept your receipts in payment of your home tax liability calculated on the basis of your total business, both home and foreign." Such a course appears to the British to leave too much to the voluntary action of the foreign country and really amounts to a subsidy for foreign trade at the expense of the home concerns. For, says the Income Tax Commission, the argument "that one British resident had contributed to the revenue of a foreign state while the other had not done so . . . would certainly not carry conviction to the ordinary taxpayer who would be called upon to make good the tax lost by any relief granted, unless the arrangement were based on a principle of reciprocity or national policy."[27] Such a principle is not present they feel except in the case of British Dominions.

The Initial Exemption.—The British Duty as passed in 1915 applied to profits which exceeded the pre-war standard by more than £200.[28] The 1917 American law applied to profits in excess of $3000 in the case of all domestic corporations, and to profits in excess of $6000 in the case of all resident individuals and domestic partnerships. If the net incomes exceeded these amounts, the excess, over the standard, was taxed no matter how small. The 1918 American law specifically exempted all corporations[29] with less than $3000 net income and included $3000 as a part of both the invested capital and profits standards, with the result that no American corporation with a net income of less than $3000 is subject to the tax. This makes the American initial exemption distinctly more liberal than the British exemption of 1915. How-

[27] Cmd. 615, p. 18.

[28] Finance (No. 2) Act, 1915, sec. 38.

[29] Individuals and partnerships were no longer taxed.

ever, when, in 1917, the British raised their rate to 80 per cent they inserted a clever but complicated provision affecting the exemption which brought substantial relief to the small profitable enterprise with a low pre-war standard.[30] The text of the section is given in full in Appendix A, IV, to which the reader is referred for the precise details and limits, but the operation of the section may be illustrated by the two following examples—

Case One—Pre-war standard £400; profits, £1000; initial exemption equals £200 (the usual allowance) plus one-fifth of £1000 (the amount by which the profits of £1000 are less than £2000) or £400 in all.

Case Two—Pre-war standard £600 (in excess of £500); profits £1000; initial exemption equals £200 (the usual allowance) plus one-fifth of £1000 (the amount by which the profits of £1000 are less than £2000) minus £100 (the amount by which the pre-war standard of £600 exceeds £500) or £300 in all.

Since the additional initial exemption is strictly limited to concerns with profits of less than £2000 and since the exemption is shaded off sharply whenever the pre-war standard exceeds £500, the relief, while very material in the small cases, automatically shuts down as the cases become large. The maximum relief which can be secured under this provision is £500, which would accrue to the enterprise with earnings of £500 and a pre-war standard not in excess of this amount. This sum is slightly less than the American exemption of $3000.

One of the proposals which will apparently be adopted with the increase in rate from 40 to 60 per cent in 1920 is to raise the figure for concerns subject to this relief from £2000 to £4000.

Rates and Dates of Application.—The 1915 act imposed a tax of 50 per cent upon profits arising during accounting periods which ended after August 4, 1914[31] and before July 1, 1915. The first date coincides with the beginning of the war. The second date was made to precede the application of the Munitions Levy[32] in order to create the opportunity at that date of dovetailing one act into the other in the ensuing year.[33] This dove-

30 Finance Act, 1917, sec. 26 (4). *Cf.* our 1918 law, sec. 302.

31 The date suggested at the time of the introduction of the measure was September 1, 1914. Debates, 74: 351.

32 *Cf. supra,* p. 6.

33 *Ibid.,* 352. For the application of the Excess Profits Duty to Controlled Establishments, *cf. supra,* p. 30.

tailing operation was accomplished by provisions included in the Finance Act of 1916,[34] and the two taxes were finally merged in 1917.[35] These 1916 amendments extended the application of the act from July 1, 1915 to August 1, 1917, making the increased rate of 60 per cent[36] apply to profits "arising in any accounting period beginning after the expiration of a year from the commencement of the first accounting period,"[37] to which the duty was applicable. For example, a concern which was taxed 50 per cent of its excess profits for its fiscal year ending August 30, 1914, was now subjected to a 60 per cent rate for its year ending on the same date in 1915, whereas a concern with a fiscal year ending on July 30, 1915, was taxed 50 per cent, the 60 per cent rate not applying until the end of the next fiscal year, July 30, 1916.

The British practice on this point during the early part of the imposition of the tax was in contrast with our own, which, with slight exceptions, insists that all profits arising in a given year shall be subject to the same rate irrespective of the date of the closing of accounting periods. In 1917 the British changed their practice sharply. In that year, when the application of the act was extended to accounting periods ending before August 1, 1918, the rate was pushed to the maximum point reached, 80 per cent, and the Government was asked that the increase not be retrospective.[38] Announcement had been made during the last days of 1916 that the rate would be increased,[39] and January 1, 1917, was seized upon as the specific date from which the new rates were to be effective. Profits arising in accounting periods which began before this date and extended over it were to be apportioned and the higher rate applied to the part falling to 1917.[40] From this time forward the rates applied uniformly to all profits arising between given dates.

This ended the anomalous situation in which two concerns otherwise similar paid different taxes because of different opening or closing dates in their accounting periods. However, it did nothing to correct the injustice which had been done to those

[34] Sec. 45. *Cf. supra,* p. 7.
[35] Finance Act, 1917, sec. 24.
[36] *Cf. infra,* p. 37.
[37] Sec. 45 (1). *Cf.* Mr. McKenna's explanation. Debates, 81:1052.
[38] *Ibid.,* 93:382.
[39] *Ibid.,* 93:383.
[40] Finance Act, 1917, sec. 20.

concerns which had been subjected to the tax many months earlier than other concerns because they happened to have accounting periods ending on dates falling sooner after August 4, 1914. The imposition of the tax on all accounting periods ending after that date had made the tax heavily retroactive.[41] The question is of considerable importance because, according to an estimate of the Inland Revenue authorities, not more than fifty per cent of the businesses in Great Britain end their accounting periods with the calendar year. It has been the intention so to adjust the tax at the end of the period of its imposition that no injustice will be done, but how the problem is to be solved in case the tax is continued indefinitely[42] is not clear. The American practice, although it has involved some complications and annoyances, has left no such heritage of difficulty for those whose duty it will be to wind up the tax.

The Finance Act of 1918 continued the Duty to August 1, 1919 at the 80 per cent rate[43] but before the passage of the Finance Act of 1919 the end of the war had come and the rate was reduced to 40 per cent on all profits arising after January 1, 1919.[44] The Duty was to apply at this rate to all accounting periods ending before August 5, 1920,[45] this date being chosen in order to make easier the termination of the tax at the end of the year. It will be recalled that it was originally imposed upon all accounting periods terminating after August 4, 1914.

The budget proposals of 1920 will make the rate 60 per cent for profits arising in 1920 and 40 per cent thereafter.

The rates and dates of application are summarized in the following statement:

[41] The tax was considered a temporary one and the general theory back of it was that it should apply to heavy profits realized and made available during the war rather than to profits specifically caused by the war. Amendments were proposed while the original bill was under consideration which aimed to eliminate this retrospective feature but they were defeated.

[42] *Cf. infra,* p. 161 *et seq.*

[43] Sec. 34.

[44] Sec. 2.

[45] Sec. 1.

SUMMARY OF RATES OF EXCESS PROFITS DUTY

In case of businesses existing on August 4, 1914		*In the case of businesses commenced after August 4, 1914*	
For first twelve months of the taxable period[46]	50%	For any accounting period ending on or before Aug. 4, 1915[47]	50%
From the end of the first twelve months to Dec. 31, 1916	60%	For the subsequent period ending Dec. 31, 1916.	60%

From Jan. 1, 1917 to Dec. 31, 1918.....80%[48]
From Jan. 1, 1919 to Dec. 31, 1919.....40%
From Jan. 1, 1920 to Dec. 31, 1920.....60%[49]
From Jan. 1, 1921 to Dec. 31, 1921.....40%[49]

The Accounting Period.—As has been noted, the accounting period has assumed a larger significance in British procedure than in American because of the fact that the British at first imposed their tax upon the basis of the accounting periods ending after a given date instead of upon the profits arising after a given date.[50] Their general practice with regard to the recognition of accounting periods also differs in certain respects from our own. Whereas in this country the accounting period must be a period of twelve months except in the unusual cases of businesses just beginning or closing operations or of changes in fiscal years, the British practice is to recognize any period for which the accounts have been made up,[51] even though it be less than a year, and consequently the Duty is calculated and paid on periods often as

[46] The first twelve months of the taxable period of a taxpayer began with the beginning of the first accounting period which closed after Aug. 4, 1914. Such accounting period may have been any length of time from one month, or less, to one year, or more.

[47] The first rate to be applied to a new business commencing after Aug. 4, 1915, was 60 per cent unless the accounting period of the taxpayer was shorter than twelve months.

[48] Dec. 31, 1916 marks the first point of time from which the same rate of tax applied to all taxpayers regardless of the ending of their accounting periods. In the case of accounting periods beginning before and ending after this date, the net income was apportioned on a time basis and the 60 per cent and 80 per cent rates applied to the respective amounts allocated to the period before and the period after such date.

[49] Rates proposed by the Chancellor of the Exchequer in 1920.

[50] *Cf. supra,* p. 34 *et seq.*

[51] Finance (No. 2) Act, 1915, sec. 38 (2).

short as three months. Where the accounts have not been made up for any definite period, or for the usual period or for more than twelve months, the Commissioners of Inland Revenue are empowered to establish the period which must be not less than six or more than twelve months. They have power, moreover, to take any period for which accounts have been "actually made up for any interim or other purpose" notwithstanding the fact that the articles of the firm require the accounts to be made up for some other period or the fact that the accounts are not issued.[52] In some cases assessments are regularly made on the basis of accounting periods of three months.

The general conception of the accounting period under British Excess Profits Duty procedure is one which draws a much less definite line between the successive periods than ours in this country. The results of the trading in one period are permitted to exert a much greater influence upon the preceding and succeeding periods than they do here. Indeed there is a marked disposition, evident particularly in the provision for losses, to view the entire period of the war as a whole and to provide adjustments which will take into account the final position of the trader after passing through the complete cycle.[53]

Determination of Profits

In determining what profits shall be subject to the Duty, the British statute utilizes the data collected for income tax purposes. However, as has been already pointed out, various modifications are necessary to fit this figure to the needs of the Duty. The general effect of these modifications is to allocate to each accounting period the true profits of a trading concern. Most of the modifications consist of deductions, such as that eliminating the income from investments. A few, however, increase the tax base as it stands for income tax purposes such as that subjecting profits from the sale of trading assets even when sold outside the ordinary course of trade. Others require a more careful allocation to particular years of items which for income tax may be taken in other periods.

A full treatment of the problem for determining taxable profits would involve a complete study of the British income tax procedure. All that is here attempted is a consideration of the par-

[52] Finance Act, 1916, sec. 51.

[53] *Cf. infra,* p. 45 *et seq.*

ticular problems directly occasioned by the imposition of the Excess Profits Duty.

General Income-Tax Principles Applied.—The Act declares that "The profits arising from any trade or business . . . shall be separately determined . . ., but shall be so determined on the same principles as the profits and gains of the trade or business are or would be determined for the purpose of the income tax, subject to the modifications set out in . . . this Act."[54]

Without the prescription that profits must be "separately determined," the Commissioners would not have been able to make the adjustments in the income of both the current accounting periods and the pre-war years which are often necessary to achieve justice, for greater precision in the distribution of such items as renewals and losses is needed for the Duty than is considered necessary for income tax purposes.

Actual Profits—not Average Profits Utilized.—In the administration of certain portions of the income tax, especially under Schedule D which includes business profits, the British made extensive use of the device of averaging the assessments of several previous years to arrive at the assessment for the given year. The Excess Profits Duty utilizes no such device. It is levied upon "actual profits arising in the accounting period." The Act specifically states, moreover, that "the principle of computing profits by reference to any other year or an average of years shall not be followed."[55]

The harshness which sometimes results in this country in the absence of some such arrangement as the averaging device is sufficiently avoided in the British Duty by a variety of adjustments, such as rebates for years of depression, exemption of appreciations of asset values, etc.[56]

Artificial Transactions to Reduce Profits Forbidden.—The following general authority is given to the commissioners of Inland Revenue to refuse to sanction deductions which appear to have been "rigged":

" . . . no deduction shall be allowed in respect of any transaction or operation of any nature, where it appears, or to the extent to which it appears, that the transaction or operation has arti-

[54] Finance (No. 2) Act, 1915, sec. 40 (1).

[55] *Ibid.*, Fourth Schedule, Part I, rule 1.

[56] *Cf. infra*, pp. 45-48, 69-73.

ficially reduced the amount to be taken as the amount of the profits of the trade or business for the purposes of this Act."[57]

Consolidated Returns.—Our 1917 law contained a vague statement[58] upon which the Treasury apparently relied in establishing regulations calling for consolidated returns in cases where they were needed to secure substantial justice. Our 1918 Revenue Act specifically demands consolidated returns whenever one corporation owns "substantially all of the stock" of another or if "substantially all of the stock of two or more corporations" is owned by "the same interests."[59]

The British practice is somewhat more narrow. In the original statute combined treatment under the Excess Profits Duty was prescribed whenever any company "owns the whole of the ordinary capital of any other company" or "so much of that capital as under the general law a single shareholder can legally own."[60] The object of this section was primarily one of relief. Without it, losses or diminished profits of one of a group of concerns might not be available for the reduction of the liability of the entire group.

Apportionnent of Income from Long-Term Contracts.—Our Treasury regulations permit[61] income from long-term contracts to be tax when actually received or to be apportioned over the life of the contract in proportion to the percentage of completion, which, in turn, is interpreted to mean in proportion to the expenditure of money for expenses in connection with the undertaking. The British statute prescribes that in such cases the usual procedure shall be to attribute to each accounting period such proportion of the profits "as shall be properly attributable to such accounting periods respectively, having regard to the extent to which the contract was performed in such periods."[62] In applying this rule the officials have taken care to insist that, if the apportionment plan is adopted for the current accounting period, it is adopted also for the pre-war period.

57 Finance (No. 2) Act, 1915, Fourth Schedule, Part I, Rule 5.

58 Sec. 201.

59 Sec. 240.

60 Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 6. This section was not to apply in the case of certain shipping transactions. *Cf.* Finance Act, 1916, sec. 47 (e), *infra,* Appendix A, III.

61 Regulations 45, Art. 36.

62 Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 11.

The British plan of allocation is more liberal than ours under which the income is distributed in proportion to the expenses incurred in each year. Our method has arbitrarily allocated profits on long-term contracts to the years in which our tax rates were highest, since the cost of labor and material were extremely high in the same years.

Modifications Due to Collection-at-Source.—The major portion of the British income tax is collected at the source. Under this system business concerns are refused permission to subtract from their taxable income certain items such as interest, rent, etc., which would otherwise be allowable deductions, the income tax rate being applied to these items before they are passed on to the recipients. On the other hand they do not have to include for income tax purposes profits or gains arising from the use of real estate in the business because such profits are cared for by a special schedule of the income tax. For purpose of the excess profits duty, however, the actual expenses are deductible and actual income must be included. Hence, the statute provided that "the principle of the Income Tax Acts under which deductions are not allowed for interest on money borrowed for the purpose of the trade or business, or for rent, or royalties, or for other payments, income tax on which is collected at the source (not being payments of dividends or payments for the distribution of profits), and under which profits or gains arising from lands, tenements, or hereditaments forming part of the assets of the trade or business are excluded shall not be followed."[63]

The necessity for such adjustments does not exist under the American law.

Deduction of Income from Investments.—The British tax is more strictly a trading profits tax than ours. In this country income from investments is or is not subject to the excess profits tax depending upon whether the recipient of such income is subject to the tax. If the recipient is a corporation, it is taxable; if not, it is not taxable, except that dividends received by one corporation from another taxable corporation, are, under our law entirely excluded for purposes of both income and profits taxes. In Great Britain income from investments is not subject to the Excess Profits Duty even when received by a business concern

[63] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 2. *Cf.*, also, Finance Act, 1918, sec. 24 (4), *infra*, Appendix A, V.

which is subject to the Duty with this single exception, that it is taken into account in the case of life insurance companies[64] and concerns where "the principal business consists of the making of investments,"[65] But taking this into account does not necessarily mean that the income from the investments is taxed, for under the British income tax laws a life insurance company is subject to taxation either on the interest on its investments (less the expenses of management, including commissions) or on the amount of its profits (including amounts alloted to policy holders). The scope of this exception is consequently very narrow. As a matter of fact, moreover, life insurance companies have not made profits high enough thus far to render them liable to the Duty.

Banks are not included within the stated exception. When firms which are included within this class receive dividends from other concerns which have already been subjected to Excess Profits Duty, an adjustment is provided for in the following general terms: "Such deduction or addition shall be made in computing the profits as will make proper allowance for that payment. . . ."[66]

Modifications Due to Variations in Capital Values.—The extreme lengths to which the British were willing to go to prevent the burden from bearing too heavily is illustrated by the section which specified that, in cases of concerns which fall within the class described above whose income from investments is subject to Duty, "any variation in the value of any of those investments which appears to the Commissioners of Inland Revenue not to be due to a variation in profits shall also be taken into account."[67] Through the authority granted by this section, the Commissioners have been able to grant deductions from investment income in cases where, owing to the diminution in the general purchasing power of money, there has been a decline in the market standing of the securities from which the income is derived. The phrase "not to be due to a variation in profits" was intended to permit such a deduction and the word "profits" to exclude deductions because of either diminished *yield* or diminished *reserves*. Moreover, it should be especially noted that, to obtain this relief, it was

[64] It should be noted that insurance companies other than life, do not become taxable on their income from investments.

[65] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 8.

[66] *Ibid.*, rule 8 (b).

[67] *Ibid.*, rule 8 (a).

not necessary that the securities be sold. The section has not been applied in such a manner as to subject to the Duty appreciations in the market standing of securities, for to do so would, according to the British concept of income, amount to double taxation of a single source of profit.

Remuneration of Managers and Directors.—When the British passed their law they were fully alive to the possibility of evasion by the distribution of profits in the guise of salaries and director's fees, a danger particularly acute in the case of concerns owned and managed by the same persons. In America increases in compensation of corporation officers were closely scrutinized and, under the 1917 law, in order to put all business organizations on the same basis, partnerships and individuals conducting businesses, in whose accounts no salary deductions had been made for managing owners, were permitted to subtract from their profits before the tax was applied sums equal to the customary salaries paid by concerns generally for similar service.

The British, however, pursued a different policy. They declined to deduct as business expenses any payments made to owners in the case of individual concerns and partnerships and included a section in the 1915 Act[68] which flatly stated that in the absence of special action by the Commissioners of Inland Revenue[69] deductions for "the remuneration of directors, managers, and persons in the management of the trade of business" should not "exceed the sums allowed for those purposes in the last pre-war trade year." Moreover the Inland Revenue officers discovered, by 1916, that this provision did not cover adequately the cases of concerns which were not in existence before the war or which, if in existence, elected to use the percentage standard in such a way as to cover the introduction of deductions for swollen salaries. Consequently they secured a retroactive provision[70] which permits them under certain conditions[71] to treat corporations whose directors have a controlling interest, as partnerships to the extent that they may disallow as deductions all

[68] Fourth Schedule, ¶ 5.

[69] The commissioners were given power to act "under special circumstances" or when the remuneration "depends on the profits of the trade or business."

[70] Finance Act, 1916, sec. 49 (1).

[71] The conditions were that the case must be one in which the pre-war standard is taken as the percentage standard or is calculated by reference to the statutory percentage.

remuneration of directors but in this case the standard is calculated at the higher statutory rate ordinarily available only to partnerships.

At the same time a concern which was forbidden to deduct certain remuneration as excessive was given the specific right to recover from the director or manager who received the excessive payment the amount of Duty it had been called upon to pay in respect of his excessive remuneration.[72] This had a double effect: (1) It became a matter of indifference to most concerns whether their payments in remuneration for services were disallowed or not and (2) it caused the Excess Profits Duty to fall upon the fortunate persons who chanced to have pre-war contracts under the terms of which they received remuneration in the form of a percentage of profits. In practice the British Treasury Department allowed an increase of not exceeding £2000 generally to go unchallenged under this provision.

If an employee is not a manager or director the restrictions described above do not apply, even though he have a profit-sharing agreement which absorbs a substantial part of the earnings of the concern. The Inland Revenue authorities state, however, that such cases are very infrequent.

The general testimony is that the provisions regarding remuneration have operated successfully and that there has been little evasion of the Duty in this direction.

Deduction of Income and Profits Taxes.—As in our law the British statute applies the Excess Profits Duty to the net income of the business before any deduction has been made for either income or profits taxes imposed by the national government. The Duty is first calculated and the amount due the Treasury is then deducted from (or "credited," in the phraseology of our law) the income subject to the income tax rates.[73] However, any sum

[72] Finance Act, 1916, sec. 49 (2). For the application of this principle to the Munitions Levy, *cf. ibid.*, 1917, sec. 24 (4). In the absence of special directions of the Commissioners such amounts recovered were to be treated as Excess Profits Duty paid by the director not the concern. This is of importance in connection with the income tax liability of the director.

[73] Finance (No. 2) Act, 1915, sec. 35; Fourth Schedule, Part I, rule 4. Munitions Levy payments are likewise deductible. Finance Act, 1916, sec. 53. Profits arising from the sale of trading stocks were subjected to the Excess Profits Duty in 1918 (*Ibid.*, 1918, sec. 35. *Cf. infra*, p. 70) but they were not subjected to the income tax. Hence the law was changed so as to forbid the deduction of Excess Profits Duty on such profits in calculating the profits for income tax purposes. *Ibid.*, 1918, sec. 31.

paid as a profits tax in a country outside the British Empire is deductible from the profits.[74] In this country under a liberal provision of the 1918 law both income and profits taxes paid to foreign countries may be offset against the local tax itself.[75] Special arrangements somewhat similar to those in the American law are made to cover the case of Britishers subject to certain colonial excess profits tax as well as to the Duty in England.[76]

Losses—General.—The British make much more liberal provision for losses than we do in this country. Not only do they permit certain deductions from current profits to restore pre-war losses but they even permit deductions from profits of previous years to restore a normal rate of return in case that is impaired by trading in current or subsequent years. Capital losses are not deducted, but capital gains are not taxed. Bad debts may be written off through the device of periodical evaluation. Inventory losses are guaged through the application of broad principles which permit the use of the "base stock" method in certain cases. Depreciation, including obsolescence and amortization are provided for on a basis which insures full eventual provision for losses due to the war.[77] The British conception of the accounting period[78] permits to a much greater extent than ours the charging back of losses against the profits of previous trading.

Deductions from Current Profits to Restore Pre-War Losses.—A provision which has no counterpart in our tax is that which allows a deduction to be made from the profit of the current accounting period to compensate for a net loss suffered as the result of the operations of the three last pre-war trade years.[79] The importance of this provision as a relief to the harshness of the Duty is self-evident.

[74] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 4.

[75] Revenue Law of 1918, secs. 222, 238. Curiously enough this provision has been resented by some of the British as an indirect hidden bonus to our foreign trade.

[76] *Cf. supra,* pp. 32-33.

[77] For losses on municipal trading ventures made good from local tax collections, *cf. supra,* p. 30.

[78] *Cf. supra,* pp. 37-38.

[79] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 7. For the application of this section to the case of sale of trading stocks otherwise than in the ordinary course of trade, *cf.* Finance Act, 1918, sec. 35 (2) (b), *infra,* Appendix A, V.

To secure this relief the profits must be actually applied to the extinction of the loss. Under the law as passed in 1915, it was further necessary that the percentage standard be the one used if the deductions were to be claimed. However, an amendment in 1916[80] permits such deductions even though the profits standard is used, provided the capital account shows a debit balance.[81]

Set-off and Repayment for Bad Years.—The American statute has adhered very closely to the conception of *annual* gain. Each twelve-month period has been forced to stand by itself, a heavy profit being taxed in the year received, taxed, too, at progressive rates and no adjustment permitted because of a heavy loss occurring perhaps the following year. Minor exceptions to this statement are the special relief provisions of the Revenue Act of 1918 which permitted net losses for the year 1919 to be charged back to 1918 and forward to 1919 if the taxable year chanced to begin between certain dates[82] and which permitted rebates in the case of inventory shrinkages under certain narrowly-defined and even more narrowly-administered restrictions.[83] In contrast with this, the British from the very beginning practically ignored for this purpose the arbitrary closing dates of accounting periods and freely allowed the rebate of Excess Profits Duty collected in time of prosperity whenever such periods were followed by depressions. Moreover, it was not merely in cases of actual losses that rebates were allowed. Whenever the profits of the concern dropped even below the pre-war standard, enough of the excess profits, previously taxed, to restore the deficit was released from assessment and the tax on that portion rebated. The general theory of the British practice on this point was, then, that the business was a continuing operation and in order to be subject to special profits taxes must show an excess profit for the entire period of its operations subsequent to the imposition of the tax.[84] But

[80] Finance Act, 1916, sec. 50.

[81] It might, of course, be desirable to use a profits standard even when the net result of the three-year period showed a loss, for the loss of a single year might, in a particular case, be sufficient to blot out handsome profits in the two other years.

[82] Sec. 204. This was available for purposes of both income and excess profits taxes.

[83] Sec. 214 (a-12) and 234 (a-14).

[84] The set-off for deficiency is calculated by applying to the amount of the deficiency the rate in force when it occurred. With rising rates cases arose where Duty was payable even though there was a net loss on the oper-

not even content with this, losses during years preceding the imposition of the tax or abnormally low earnings during such years were also made the basis for the extension of special relief.[85]

The exact language of the statute governing the set-off and repayment for years of depression is as follows:—

"Where a person proves that in any accounting period, which ended after the fourth day of August, nineteen hundred and fourteen, his profits have not reached the point which involves liability to Excess Profits Duty, or that he has sustained a loss in his trade or business, he shall be entitled to repayment of such amount paid by him as Excess Profits Duty in respect of any previous accounting period, or to set off against any Excess Profits Duty payable by him in respect of any succeeding accounting period, such an amount as will make the total amount of Excess Profits Duty paid by him during the whole period accord with his profits or losses during that period."[86]

The importance of this provision in eliminating friction and discontent on the part of those subject to the Duty can scarcely be overestimated. Its presence in the British statute goes so far to alleviate the harshness of the levy that any comparisons with the American law which do not take it into account are obviously worthless.

The interpretation of this section is so broad as to make its value to the taxpayer even greater than would appear at first glance. Thus when a person is subject to Excess Profits Duty with respect to two separate businesses, he may set off a deficiency below the pre-war standard in one business against any excess profits he may have in the other. Deficiencies in the case of a partnership may be apportioned for the purposes of this set-off.

In the case of shipping companies it was found necessary to restrict to some extent the relief afforded by this section. Thus, after January 1, 1917, the provision was not available to such companies, except in cases where there was an actual loss or where the profits did not equal the mark established by the percentage standard, in which case a repayment was made which restored enough profit to bring the income up to the percentage standard.[87] The reason for this provision was the conviction on the

ations of the entire period. In such cases no Duty was collected, and the case held in abeyance pending a final adjustment. In no case is Duty collected in excess of the net excess profits realized. Statutory authority for this practice has not yet been given, however.

[85] *Cf. infra,* Appendix A, II.

[86] Finance (No. 2) Act, 1915, sec. 38 (3).

[87] Finance Act, 1917, sec. *22.*

part of the Government that the shipping industry had made inordinately large profits.[88]

Depreciation.—The British have been slow to recognize in their income tax procedure the importance of full depreciation allowances. Although their present income tax was established in 1842, it was not until 1878 that Parliament authorized any deductions at all for this purpose and even yet allowances are restricted to traders and are ordinarily limited to machinery and plant. However, the pressure of conditions of operation under the stress of war and the heavy rates of income and profits taxes have worked a revolution in the British practice on this point. At the present time the allowances for purposes of the Excess Profits Duty are liberal and complete, although certain of them are available only upon appeal. Ordinary depreciation of plant and machinery is given under general rules as a matter of course. Extraordinary depreciation and obsolescence is cared for under a special section of the law (Section 40).[89]

Ordinary Depreciation of Plant and Machinery.—The original Excess Profits Duty statute contains this comprehensive provision:

"Deductions for wear and tear or for any expenditure of a capital nature for renewals, or for the development of the trade or business or otherwise in respect of the trade or business, shall not be allowed except such as may be allowed under the Income Tax Acts, and if allowed shall be only of such amount as appears to the Commissioners of Inland Revenue to be reasonably and properly attributable to the year or accounting period."[90]

This limits its deductions to those depreciation allowances permitted for income tax,[91] but the section must be read in connec-

[88] Debates, 93: 387. *Cf. supra,* p. 20-21. For a restriction upon the application of the section to Industrial and Provident Societies *cf.* Finance Act, 1917, sec. 26 (8), *infra,* Appendix A, IV.

In 1918, when profits arising from the sale of trading stocks other than in the ordinary course of business were brought to account for purposes of the Excess Profits Duty, it was arranged that this relief section should have effect as if the profits arising from the sale "had been made by the owner of the business immediately before the appointment of the liquidator," etc. *Ibid.,* 1918, sec. 35 (b).

[89] The Royal Commission on the Income Tax recommends the extension of these allowances to other than traders. Cmd. 615, p. 48 *et seq.*

[90] Finance (No. 2) Act, 1915, Fourth Schedule, Part I, rule 3.

[91] It should be noted, however, that the phrase reads "such as *may* be allowed under the Income Tax Acts." This is not interpreted to mean what *have*

tion with another (Sec. 40 (3)) which permits special treatment in special cases.[92] However, the mere fact that an allowance has been made for income tax is not enough to insure its deduction *in that particular year* for purposes of the Duty. Under the Income Tax Law no objection is usually made to variations in the amount expended for renewals and repairs in any one year, as it has been considered immaterial in the long run whether or not such renewals were chargeable in one year or over a period of years. However, for the purpose of the excess profits tax the time of charging the renewal is important, and the Board of Inland Revenue insists upon adjustments. For example, a restriction is placed upon the amount which might be expended on renewals during the period of the excess profits tax. Thus, if an asset is renewed once in twenty years and the whole expenditure is allowed for income tax when incurred, an adjustment is necessary in order to obtain a proper comparison of the earnings of the pre-war period with the earnings of the taxable period. Otherwise the result might show an artificially low pre-war earning or an artificially low profit during the war period. In cases in which a special claim is made that the rate of depreciation which has been accepted for income tax purposes has been inadequate and such claim is admitted, the pre-war income is also adjusted according to the new rate of depreciation in order to provide a proper basis of comparison. But in other cases where the rate of depreciation has been adequate in the past but is considered inadequate in the year of taxation, greater allowance may be granted in that year without readjustment of the pre-war allowance.

Ordinarily depreciation allowances under the Income Tax are limited to plant and machinery. Consequently if depreciation is desired for other items it is necessary to proceed by way of an appeal under section 40 (3).[93]

The ordinary depreciation rates allowed are much more highly standardized in Great Britain than they are in this country. Here the initial determination of the precise rate is left entirely to the taxpayer, only the most general statements being given

been allowed. *E.g.*, an asset which depreciates more rapidly at first than later may be allowed a varying depreciation rate for Excess Profits Duty without disturbing the uniform rate used in the Income Tax.

[92] *Cf. infra*, p. 50 *et seq.*

[93] *Cf. infra*, p. 50 *et seq.*

for his guidance in the Treasury regulations. He is subject to correction, of course, if upon subsequent audit his deductions appear exorbitant. What is considered exorbitant by the auditors has not been reduced to specific terms. It is difficult to do this, but something could be accomplished in establishing rates for ordinary conditions if elasticity is provided for special cases. Great unevenness as between essentially similar concerns now inevitably results.

In Great Britain they have proceeded so far as to arrive at general rates of depreciation for classes of trade or business through agreements between the Inland Revenue and the trade itself. In 1918 a White Paper was issued[94] containing the agreements arrived at before that date. This is reproduced below. There have been a number of agreed rates established since.

The procedure of establishing general depreciation rates for classes of trade or business was elaborated and formalized by the passage of an amendment to the income tax in 1918. This legislation provided for a reference to the Board of Referees, hitherto used exclusively for Excess Profits Duty purposes, of applications "made by or on behalf of any considerable number of persons engaged in any class of trade or business" for alterations in any deduction for wear and tear. In other words, the arbitration principle is invoked to assist in the establishment of these general rates for ordinary depreciation and deadlocks between the Inland Revenue and the classes of taxpayers are thus avoided. This power of appeal has not yet been utilized.[95]

Depreciation allowances are originally passed upon by the local surveyors who settle all but the most difficult cases and who operate under standing directions to proceed in a liberal manner in dealing with the taxpayer.

Exceptional Depreciation.—Great elasticity was introduced by Section 40 (3) of the Act which vested in the Commissioners of Inland Revenue authority to approve taxpayers' petitions for relief.[96] Such petitions might be presented when, among other grounds, there was loss due "to the postponement or suspension, as a consequence of the present war, of renewals or repairs, or to

[94] Cmd. 9134.

[95] Finance Act, 1918, sec. 24 (1). Sec. 24 (3) of this act merely gave statutory sanction to ordinary income tax practice with regard to depreciation.

[96] *Cf. infra,* p. 117 *et seq.*

Schedule of Agreed Rates of Depreciation

Industry, &c.	Rate per cent	Prime Cost or Written-down Value.	Nature of Plant.
Electric Light Undertakings.	3	Written-down value	Cables.
	5	" "	Plant and machinery.
Flax Spinning and Linen Weaving (Ireland).	7½	Written-down value	Machinery and plant (except accessory plant such as pirns, pirn cages, spools, belting, driving ropes, damask cards, designs, patterns, models, furniture and fixtures).
Flour Milling.	5	Written-down value	Engines, boilers and main shafting.
	7½	" "	Other machinery.
Gas Undertakings other than those owned by municipal or other public authorities.	3	Written-down value	Gasholders.
	10	" "	Meters, cookers and gas fires.
Motor Omnibuses[1]	20	Written-down value	Motor omnibuses.
Paper Mills.	5	" "	Machinery working day only.
	7½	" "	" " " and night.
Printing.	5	Written-down value	Engines, boilers and shafting.
	7½	" "	Printing and binding machines
	10	" "	Type.
Railway Wagons.[2]	5	Written-down value	Railway wagons.
Shipping.[3]	4	Prime cost	Steamships.
	3	" "	Sailing vessels.
Steel Manufacturers.[4]	15	Written-down value	Machinery and plant used in the manufacture of steel.
Timber Merchants, Saw Millers, and Manufacturers of Timber Goods.	5	Written-down value	Engines, boilers, and main shafting.
	7½	" "	General saw-milling plant and machinery.
	20	" "	Traction engines, tractors, motorcars, and haulage plant.
Tramways.[5]	—	—	Permanent way.
	3	Written-down value	Cables.
	7	" "	Cars and other rolling stock.
	5	" "	General plant and machinery, including standards, brackets, and work-shop tools.

[1] The rate of 20 per cent is to be re-considered at the expiration of four years commencing with 1916-17.

This rate does not apply to commercial motor vehicles.

[2] The allowance applies to all wagons owned by traders.

In the case of railway companies the method adopted is to allow the actual cost of renewals year by year.

[3] With regard to ships *purchased at secondhand* at prices in excess of the written-down value at the date of purchase, the following arrangements have recently been made:—

(*a*) The allowance is made on the actual cost price of the ship to the owner for the time being without regard to the prime cost to a previous owner.

(*b*) The rate of depreciation allowable is calculated by reference to the reasonable expectation of the life of the ship at the date of purchase from the previous owner.

[4] The rate of 15 per cent represents 5 per cent for normal wear and tear, and 10 per cent for the additional wear and tear arising from war conditions.

[5] An allowance per mile of track based upon the estimated life of the permanent way.

exceptional depreciation or obsolescence of assets employed in the trade or business due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war."[97] Blanket power "to allow such modifications . . . as they think necessary in order to meet the particular case" rests with the commissioners.[98] It is apparent that, with this ample authority, a proper spirit of fairness in the administration was all that was needed to solve the large number of special cases of hardship which inevitably arise in a complex business situation. In addition, however, in order to guard against the possibility of dissatisfaction through arbitrary administrative action, a petitioner might appeal from the decision of the Commissions to the Board of Referees.

It should be pointed out that whereas ordinary depreciation is limited to machinery and plant this special section applies to exceptional depreciation or obsolescence of *assets employed in the trade or business.* Consequently it is possible to grant deductions for depreciation in any type of asset. Acting under this authority the Inland Revenue permits the taxpayer to depreciate such items as patents (to the extent that loss is suffered "through effluxion of time" and is not offset by the development of goodwill). No allowance is permitted for depreciation of the cost of leaseholds or of good will.

It is apparent further that the assets subject to the allowances for unusual depreciation or obsolescence need not be property specifically purchased for the purpose of manufacturing war materials. Any assets in the taxpayer's business adversely affected by the war come within the scope of the provision.

The extent of the loss which may be depreciated or amortized for purposes of the Excess Profits Duty is established on a liberal basis. The rule is that the total amount subject to deduction is the difference between "war value," (*viz.*, the value of the asset at the beginning of the first accounting period, when the Excess

[97] Finance (No. 2) Act, 1915, sec. 40 (3).

[98] In 1916 when the application of the Act to shipping companies was made more stringent, an amendment prescribed that nothing in the section quoted above should operate to enable the purchaser of a ship to obtain greater relief than the vendor could have obtained, had the ship not been sold, other than "relief in connection with expenditure by the purchaser on improvements or repairs."

Profits Duty began to apply or the cost price if acquired after that date) and the "post-war value" (*viz.*, the market value of the asset at the end of the last accounting period subject to the Duty or some other post-war date to be fixed subsequently). In other words the total diminution in the value of assets due to war conditions and occurring during the period of the application of the Duty may be charged off. Moreover, that diminution may be charged off against the profits of the whole war period and not merely against the profits of the accounting period in which the loss is disclosed.[99]

Post-war value being for the present an indeterminate quantity, the practice of the Inland Revenue has been to hold in abeyance most questions of unusual depreciation and obsolescence. For a time an arbitrary rule limiting tentative deductions in any one year to twenty per cent was in force[100] but it was made very clear that this was a tentative allowance. Even this limitation has since been abandoned. At present reasonable allowances, without specific limitation, may be claimed for current periods but they are regarded as *interim* concessions, subject to readjustment upon the final settlement at some future date.

Amortization.—That part of the section quoted above which reads "owing . . . to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war" is construed to give ample authority for amortization deductions. Such deductions are attributed to the entire war period and not merely to the year in which disclosed.

Postponed Repairs.—In cases where, because of the pressure of war work, repairs have not been made, an arrangement is pro-

[99] Deputation from the Executive Council of the Association of Chambers of Commerce of the United Kingdom to the Chancellor of the Exchequer, April 3, 1918, p. 10 *et seq.*

[100] In this country in cases of amortization allowances for property whose post-war value has not been determined definitely, the tentative deduction in a single year is apparently restricted to 25 per cent of the cost of the property. (T. D. 2859.) This restriction has been severely criticized and may perhaps not be rigidly adhered to in all cases. The Department does, however, adhere in its assessments to a reduction in value to current values in the year of assessment and refuses to make tentative or provisional allowances in anticipation of a drop in values by the time the three-year period specified in our statute has expired.

vided under Section 40 (3) which permits the deduction of amounts representing the probable cost of such repairs from the profits of the current accounting period.[101]

Obsolescence.—War obsolescence is specifically mentioned among the grounds justifying appeal for special treatment from the Commissioners of Inland Revenue[102] under the section quoted above and such deductions have been fully considered in that place.

In order to increase the supply of scrap metal during the war, manufacturers were urged to discard all obsolete machinery. The Inland Revenue did what it could to encourage this tendency by ruling that sums realized from the sale of such machinery would not be subject to income and profits taxes as an ordinary receipt but should be held as a reserve for replacements. When the replacements are made the residual book value may be written off as a charge against profits for that year. In the case of the Excess Profits Duty an allowance is made for war obsolescence when settling the assessment for the year in which the plant was scrapped and notwithstanding the fact that it may not have been replaced.

Depreciation in Controlled Establishments.—Some irregularity was introduced into the allowances for depreciation in the course of the administration of the Munitions Levy. This levy, it will be recalled,[103] was under the control of the Ministry of Munitions whose chief function was, after all, the production of the articles needed in the war. The natural tendency was to subordinate other considerations to that end and it became the practice to encourage extension of plants and expansion of manufacturing activity by assurances of liberal depreciation allowances in calculating the Munitions Levy.[104] These allowances were often far

[101] *Cf. infra,* p. 117 *et seq.*

[102] Finance (No. 2) Act, 1915, sec. 40 (3). *Cf. infra,* p. 117 *et seq.*

[103] *Cf. supra,* p. 6 *et seq.*

[104] Sir J. Harmood Banner described the situation in these words: ". . . the Minister of Munitions had made this arrangement with a great many controlled firms: 'You spend so much money . . . for the purpose of increasing the supply of munitions, and I will give you special terms for depreciation, in order to induce you to do that. . . .'" In this speech an illuminating reference was made to the absence of complete harmony between the Minister of Munitions (Mr. Lloyd George and the Chancellor of the Exchequer (Mr. McKenna)). "I looked with some amusement to see the Minister of Munitions sitting beside the right hon. Gentleman. I think I

more liberal than those permitted for income tax purposes which, in turn, were the foundation for the determination of profit for the Excess Profits Duty. In dovetailing the Munitions Levy into the Excess Profits Duty it was strongly urged that the establishment of the arrangement whereby the concern paid the higher tax[105] constituted an abrogation of contract unless accompanied by a recognition by the Inland Revenue of the depreciation allowances sanctioned by the agreements of the Ministry of Munitions. This is the explanation of the section of the Finance Act of 1916[106] which prescribed that any items of exceptional depreciation or obsolescence of buildings, plant or machinery disallowed for income tax purposes should be recognized and the proper repayments of income tax made.

Depletion.—It has never been the custom under the British Income Tax to permit deductions for the depletion of wasting assets, but under the Excess Profits Duty it has been considered advisable to take this element into account. The reasons for this difference of treatment are embedded in the general thory lying back of their income tax practice. In arriving at taxable income, they aim to eliminate capital factors. In general, increases or decreases in the value of capital assets do not enter into the computation. It is true that there has been a gradual recognition of depreciation of plant and machinery as a proper deduction but the line has been sharply drawn between such assets and those ordinarily subject to depletion. The content of a mine,

saw the Chancellor of the Exchequer turn around a little, and I am not quite certain whether he was sure of the approval of the Minister of Munitions. . . ." Debates, 81:1088. Mr. McKenna later pointed out with great directness the relative success of the Excess Profits Duty for which he was responsible as compared with the Munitions Levy of Mr. Lloyd George. "The revenue derived from that tax (the Excess Profits Duty) has been enormously in excess of the Estimate. . . . Perhaps at some other time he (the Chancellor of the Exchequer) will give us the amount which has been collected under the Munitions Levy since its first adoption as far back as July, 1915. I venture to say that the Committee will find—I do not know the figures—that the amount collected from all the controlled firms is practically negligible." Mr. Pringle: "Eye-wash." Debates, 93:396.

[105] *Cf. supra,* p. 30.

[106] *Sec.* 39. *Cf. infra,* Appendix A, III. *Cf.* also *ibid.,* sec. 55 and Finance Act, 1917, sec. 16. Mr. Baldwin, Lord of the Treasury, assured the House of Commons in 1917 that munitions firms would continue to receive the customary allowances even after coming under control of the Inland Revenue. Debates, 93:434.

they argue, was originally a gift of nature. The original owner paid nothing for it. Every new purchaser since 1842, when the Income Tax was established, paid his price "on notice" that the income realized from the property would be subject to income tax without allowance for depletion. If it is recognized that this factor must tend to reduce the capital values of mining properties as compared with property in general, they either (1) ignore it on the ground that such incidental effects on capital values lies outside the scope of consideration in the case of income tax or (2) reply on the general philosophy which justifies the existence of the Mineral Rights Duty and Excess Mineral Rights Duty, *viz.*, that income from mines, *etc.*, is a particularly suitable subject for special taxation.[107]

However, the theory back of the income tax holds together only so long as the tax is one which is foreseen and counted upon. In arriving at the price of a mine, say in 1910, the buyer could not have been said to have anticipated an Excess Profits Duty which had not yet been invented. Consequently there was no "cushion" here (in the shape of smaller purchase price paid by the owner) to absorb this shock. As compared with other enterprises where depreciation was allowed and which had no wasting assets of the nature usually provided for by depletion, the owner of mining enterprises was in a very weak position for he would, in the absence of some special provision, be subjected to rates of from 40 to 80 per cent upon sums which were really merely a return of the capital invested when he bought the mine.

The British administrators recognized this fact and appreciated the necessity for providing relief. There was no statutory authority to allow depletion deductions in arriving at taxable profits. But there was power vested in the Board of Referees to increase on appeal the statutory percentage on invested capital. Consequently under section 42 (1), which provides for appeals "for an increase in the statutory percentage as respects any class of trade or business," the cases of hardship as the result of the non-allowance of a depletion deduction are cared for.[108] There may be some slight deduction for wasting assets provided for

[107] For a very interesting and able discussion of this problem *cf.*, Report of the Royal Commission on the Income Tax. (Cmd. 615), p. 43 *et seq.* The Commission recommends a very limited deduction in the case of wasting assets in arriving at net income for purposes of the income tax.

[108] *Cf. infra*, p. 125.

theoretically in the ordinary 6 and 7 per cent allowance on capital and, moreover, when the Duty is calculated by comparing present profits with pre-war profits, depletion being included in both, the problem would normally be canceled out. However, even a cursory inspection of the additional percentages allowed by the Board of Referees indicates the importance attached by them to this element of wasting assets. Thus, certain classes of mines which have been passed upon have been granted increases varying from 2 to 21½ per cent while the range of additions in the case of other concerns has been from nothing to 9 per cent.

Inventories.—The treatment of inventories or "trading stocks" presents peculiar difficulties in connection with the application of a special profits tax. The chief problem is fundamentally that of covering the risk of unfavorable price fluctuations. If one views the war period as a whole the price level shows a very great rise as compared with the pre-war level. There is a general expectation that a considerable fall will follow. Great as this general movement has been, the price changes of individual commodities have, of course, been much more violent and abrupt, involving in the cases of particular taxpayers correspondingly large gains and losses. If the valuations of stocks held by a trader follow the market prices, the successive balance sheets reflect the market variations and show a series of profits equal to the increased prices of the stocks carried as the market moves upward and a corresponding series of losses as the market moves downward. Of course, a truly accurate balance sheet should reflect the exact present worth of a business but it is obvious that, in so far as the item of net worth contains an element of unrealized profit on items whose prices will probably fall before realization, conservative management calls for special treatment through a reserve, either an open one or a hidden one in the form of some arbitrary, conservative method of valuing inventories. If the profits tax is applied to the war (and post-war) period as a whole (as our tax is not applied), losses suffered on the downward price trend being offset against profits made on the upward trend; if the rates of tax are held at the same level throughout and if the tax is continued in force until the end of the period of readjustment, there would be little ground for complaint from the taxpayer with a policy which insisted upon inventory valuations at

market price with no allowances for reserves.[109] Where these conditions are not met, distress is inevitable unless mitigating measures such as reserve allowances or arbitrary rules of valuation are accepted by the tax authorities.

In our own practice we cannot flatter ourselves that we have met this problem in an entirely satisfactory manner. Our general rule of inventory valuation provides the option between "cost" or "cost or market whichever is lower." In all concerns except those with the most sluggish of turnovers this results in a close correlation between inventory valuations and market prices. While it is possible to write down values in such cases as that of obsolescence, no formal provision is made for general reserves against possible declines in prices. Consequently there is no doubt at all but that we have levied heavy taxes upon a large quantity of profits which consist merely of the increased values of inventories while we have made practically no provision for returning these taxes in case the profits prove illusory because of a reverse movement of prices. Our general conception of the accounting period practically insulates each year's trading from every other, so that a net loss suffered during a year of declining prices may not be used to cancel taxes on the profits shown on the balance sheet during a year of rising prices. It is true that the Revenue Act of 1918[110] included a concession which was apparently designed to erase partially for this purpose the dividing line between the years 1918 and 1919 but it did not go far toward a solution of the problem.[111]

The general rule for valuing "trading stocks" in Great Britain is virtually the same as our own, "cost or market whichever is lower," but it has long been the practice of the Inland Revenue to admit, under restricted conditions,[112] inventories appraised in accordance with the so-called "base-value" or "base stock" principle. This principle is used in certain base-metal manufacturing trades such as copper, pig iron, lead, spelter, etc. for part of their materials "on the theory that it is necessary for the under-

[109] There would still be, of course, the injustice involved in holding the taxpayer's money between the time of collection and eventual refund.

[110] Secs. 214 (a-12) and 234 (a-14).

[111] This section was construed by the Treasury in Sections 263-267 of Regulations 45.

[112] This method must be the general practice of the trade. The problem as to what constitutes the general practice is similar to the problem of determinating the classes in appeals to the Board of Referees. *Cf. infra,* p. 129.

takings using them to keep a reserve stock to protect themselves against strikes and adverse fluctuations in market values, etc."[113] The basis in such cases "represents what may be called a minimum cost over a series of years for a minimum quantity; in theory keeping this minimum quantity untouched and unused, although in practice no actual reserve stock may be kept which could be identified at any time; any excess over this amount is valued at cost or market value, whichever is the lower."

Moreover, one must keep in mind the fundamental differences between the American practice and the British which lies in the fact that they freely erase the lines between accounting periods, charging losses back against previously taxed profits.[114] This has, of course, a profound effect in giving relief to the taxpayer.

Finally the British have adopted certain special measures of relief and contemplate the adoption of still others.[115]

The Rules of the "White Paper" of 1917.—The special modifications of the general rules were made when the Finance Bill of 1917, raising the rate to 80 per cent, was under consideration. At this time the whole question of the valuation of trading stocks became a storm-center. Deputations urging special treatment besieged the Government[116] and a private bill amending the Finance Act was introduced into the House of Commons.[117] The

[113] Opinion given by the Committee of Consulting Accountants advising the Ministry of Munitions in regard to Munitions Levy, June 14, 1917. *Cf. infra,* Appendix F.

[114] *Cf. supra,* p. 45 *et seq.*

[115] *Cf. infra,* p. 62 *et seq.*

[116] *E.g.* The Association of Controlled Owners, later reorganized as the Federation of British Industries.

[117] The proposed amendment to the Finance Act read as follows: "At the end of each and every accounting period the stock then on hand shall be brought into the accounts for such period as to any quantity not exceeding that brought into account at the commencement of the first accounting period (hereinafter referred to as "normal stock") at the same prices as those at which the latter was so brought into account and as to any quantity in excess of the normal stock at the prices at which the same was acquired or at the market value thereof, whichever the lower; provided that, if at the end of the last accounting period the stock in hand be less or more than the normal stock, the deficiency, if any, may be made good, and in such case shall be deemed to have been acquired during the last accounting period and be chargeable accordingly, and for any excess a period shall be allowed in which to ascertain by actual realisation the value thereof, and the same shall be brought into account at the prices so realised."

Government referred the question to a committee of prominent accountants who advised certain concessions but opposed most of the proposals submitted by the petitioners. The report of the accountants is printed in an appendix to this monograph (Appendix F). Acting upon the advice of this committee the Government refused to agree to the suggested amendment but offered certain concessions in the form of a "White Paper" which it eventually put into effect through action by the Commissioners of Inland Revenue, without additional legislation, under authority of Section 40 (3) of the statute. This memorandum gives the modifications in the general principles of valuing inventories which the Inland Revenue now recognizes for purposes of the Excess Profits Duty. The importance of these rules merits their statement in full:

Valuation. General Principle.—The Board of Inland Revenue are prepared to adopt the following modifications of the general principle that stocks should be valued at cost price or market value, whichever is the lower.

1. *Final Valuation. General concession for Excess Profits Duty.*—A period of two years will be allowed after the termination of the war in which to ascertain by actual realisation the value of the stock appearing in the account at the end of the last Accounting Period, and an allowance made from the profits of that period for any difference between the valuation and the sum realised.

The loss (if any) on only such stocks as were in hand at the end of the last Accounting Period will be brought into the adjustment, but the whole of such stocks, not individual parcels selected by the taxpayer, must be considered.

The necessary sanction for this modification of general principles will be given by a Regulation under section 40, sub-section 3, of the Finance (No. 2) Act, 1915.

2. *Treatment of "Base Stocks."*—Certain classes of industry require to keep stocks of raw or semi-manufactured goods for the purposes of manufacturing processes, and these goods are frequently of such an imperishable character that a minimum quantity required for a business could be held untouched for a long period.

Accordingly any class of trade—

(*a*) which requires for its manufacturing processes to keep such stocks, *and*

(*b*) in which a recognised practice has obtained of valuing a constant quantity at a fixed price,

the Board of Inland Revenue are prepared to recognise the practice.

The Board of Inland Revenue would regard goods as imperishable which are of sufficient durability to last without material deterioration during a period equal to the length of the war.

Any individual member of the class who has not adopted the method in his business may be allowed to do so for the purposes of Excess Profits Duty, but may not claim as the constant quantity of stock so valued a greater quantity than the minimum amount held at any stock-taking in the three pre-war trade years.

Where a claim is made that an industry should be brought within this concession, the Board of Inland Revenue are prepared to receive representations and to consider evidence as to the existence of a material body of such practice in the industry and as to the character of the stocks to which it is claimed the method should be applied, with a view to securing the uniform treatment of all members of the industry.

The balance of stock above the minimum quantity in cases falling under this modification of the general principle is to be treated as in (1).

3. *Replacement of minimum quantities in certain circumstances.*—Profits derived from sales which reduce stock below the particular minimum or constant quantity adopted for any business are not the less trading profits. Where, however, a raw material is associated with plant in a manufacturing process (e.g., metal kept to a constant level in galvanizing baths), the Board of Inland Revenue will consider a claim under section 40 (3) of the Finance (No. 2) Act, 1915, that it is akin to a capital asset, like plant, which has been exceptionally depreciated (by depletion) or of which the renewal has been postponed.

4. *Hidden stock reserves generally.*—Where in an industry or as respects a class of stock to which the foregoing (2) does not apply, the owner of a business has taken a quantity of stock at a base price, the stock will fall to be valued during the periods of liability at cost or market value, whichever is the lower; but from the final valuation (on that basis) there will be allowed a deduction of a sum (in pounds sterling) equal to the original difference (at the end of the standard period) between the valuation on the base method and a valuation on the cost or market value method. Alternatively, the first stock valuation may be revised and put upon the general basis of cost or market value, when the modification outlined in (1) will apply.

Rule 1 of the above memorandum sets at rest the fear that a sudden repeal of the Excess Profits Duty before prices had readjusted themselves might leave taxpayers without any provision for using inventory losses suffered after the repeal to offset profits which had been subjected to the Duty. It should be noted that the language of the rule that an allowance will be made "from the profits of that (last accounting) period for any difference" is not so interpreted as to exclude carrying back still further any part of the loss too great to be set off against the profits of that

last period.[118] An important restriction is that which limits the loss to that "on only such stocks as were in hand at the end of the last Accounting Period," for there may be, of course, a series of successive losses during the process of returning to the permanent price level.

Rule 2 is narrowly restricted in its application. It does not extend, for example, to concerns which ordinarily use the "base value" method in their accounts but fall within a trade where the method is not the general practice. Such concerns must discard their usual methods and take their inventories on the cost or market basis. On December 5, 1918, it was reported that only about twenty-four applications had been made for permission to use this method. Fourteen had been rejected or abandoned by the applicants; in five cases the concessions had been granted for sections of the stock and the remaining five cases were pending.[119]

These then are the rules which control the procedure as it stands today.

The Committee on Financial Risks Attaching to the Holding of Trading Stocks—Dissatisfaction with the extent of the relief afforded under the rules of the White Paper, coupled with the conviction that the whole problem of stocks would be of vital importance in the years following the war lead to the establishment in February, 1918, of a special committee of ten prominent business and professional men[120] "to enquire and report as to any measures which could be adopted with a view to securing that manufacturers and others should be financially in a position to hold stocks after the war, and that reasonable safeguards are established to prevent serious financial losses as a result of possible depression following on a period of great inflation, in respect of stocks of materials required for industry."

The report of the committee submitted on December 5, 1918,

[118] Deputation from the Executive Council of the Association of Chambers of Commerce of the United Kingdom to the Chancellor of the Exchequer, April 3, 1918, p. 16.

[119] Report of Committee on Financial Risks attaching to the Holding of Trading Stocks. Cmd. 9224, 1919.

[120] The members of the committee were as follows: Mr. F. C. Harrison, C.S.I., (*Chairman*); Mr. Cecil L. Budd, C.B.E., Mr. J. E. Davison, Mr. Ernest R. Debenham, Mr. G. Binney Dibblee, Mr. A. W. Flux, Mr. A. J. Hobson, Mr. William McLintock, Dr. J. C. Stamp, C.B.E., Sir Richard Vassar-Smith, Bart, with Mr. R. C. Smallwood, as Secretary.

makes a strong plea for further relief[121] to the holders of stocks purchased at high prices.

The testimony before this committee revealed the fact that there was a strong demand for the wider application of both rule 1 and rule 2 of the White Paper and for still additional relief beyond this. Single traders who used the "base value" method resented being placed upon another basis because they chanced to fall within a trade in which this method was not generally used. A majority of the committee, however, reported that the "base stock" method was "repugnant" to their views "as to the correct system of accounting"[122] and formulated their conclusion in these words: "In our judgment industries which have obtained this concession have established no further title to relief. They will commence the post-war period with stocks valued considerably below their market price."[123] Four out of the ten members of the committee differed sharply on this point and signed a minority report which contained the following clauses in which they record their faith in the correctness of the accounting theory back of the "base value" method and urge its recognition in the case of any individual concern desiring to adopt it:

> To maintain the stability of trading concerns and particularly of Joint Stock Companies, we regard it as desirable, for the future, that all firms and companies so electing, should be permitted to adopt the base price method of stock valuation, independent of taxation; but the prices must not be lower than they have actually reached "at cost or market value" within the trader's experience.
>
> We are of the opinion that the base stock method of eliminating from trading profits the fluctuations in stock values, is preferable to the creation of reserves from profits enhanced by rising markets, and using up such reserves against losses in falling markets, as the more accurate ascertainment, and more equal distribution of actual trading profits, over a longer period than one year, which results from the method we advocate, stabilises the business and enables loan, or preference capital, to be obtained on better terms.[124]

The case against the adequacy of Rule 1, which makes allowances for the fall in value of stocks held in the last accounting period to the extent to which they are realized in the succeeding two years, is admirably stated in the following excerpt from a

121 Cmd. 9224.
122 *Ibid.*, p. 5.
123 *Ibid.*
124 *Ibid.*, p. 8.

memorandum drawn up by the Association of Chambers of Commerce of the United Kingdom:[125]

The Government appear to recognise it as reasonable that having taken from manufacturers a large share of their profits, when they were purchasing on a rising market, there should be some deduction and allowance at the end of the last accounting period when the reaction comes, and manufacturers are selling on a falling market. Rule 1 is obviously inadequate for several reasons, of which the most obvious is, that it operates only when there is an actual realisation of the stock carried at the end of the last accounting period. A manufacturer does not realise his stock of raw materials or semi-manufactured goods, he converts them into fully manufactured goods. Rule 1 operates only once, and it makes no allowance for the fact, that the manufacturer has to go on manufacturing and selling on a falling market. He may rid all his manufactured stock a month or three months after the end of the last accounting period, the price of these goods may not have fallen at all and he will then get nothing under Rule 1, though a serious fall in the value of his raw materials and partly manufactured stock may have begun and may be going to continue for many months. A loss under Clause 1 will be exceedingly difficult to prove for several reasons.

It is assumed by the Commissioners of Inland Revenue, that a loss can only be the difference between the sum realised and the valuation of the stock at the end of the last accounting period. Evidently it is necessary for a firm to continue to bear business expenses in the next accounting period in order to realise stock, and to say that the whole of the gross proceeds of such realisation must be set against the valuation of stock, necessitates that all the standing charges necessary to realise such stock shall be lost by the firm continuing business before any claim for loss will be entertained by the Commissioners.

A second difficulty in making a claim is due to the fact that raw materials and partly finished goods have to be finished at a further expenditure of money during the new accounting period before being ready for sale. The Officials at Somerset House have defended the proposition that such further expenditure is entitled only to be replaced without gross or net profit, when the goods are ultimately sold, before a loss can be charged. As an illustration, if £100 worth of goods in stock require a further £100 to be expended upon them to make them into a saleable commodity and are then ultimately sold for £200 the Officials to the Inland Revenue Commissioners would hold that no loss had been incurred, whereas it is quite evident to the trader that he had had to provide capital and expenses from the new year's turnover at a sacrifice of the whole of his anticipated gross

[125] Monthly Proceedings, May, 1918. This memorandum is said to have come from the able pen of Mr. A. J. Hobson, a member of the Committee on Financial Risks and then Vice-President of the Association.

and net profits on such enterprise, in order to protect the Inland Revenue against loss upon stock consumed in the production of such goods.

A third difficulty that arises is that a loss can only be allowed "on such stocks as were in hand at the end of the last accounting period." In most manufacturing businesses there is no system of accounting which shows which raw materials or partly finished goods ultimately become goods for sale in the subsequent accounting period. In the absence of such system of accounting it would appear to be hopelessly impossible to prove on which goods in stock the loss took place, after they had been blended in the new accounting period with goods acquired subsequently to the date of the stock taking. In view of this difficulty in establishing a claim for himself, the position of a manufacturer, and to some extent also of a merchant who requires to hold stocks of goods to retain the good-will of his business, appears to be that the increment in value of such stocks as are essential to the continuity of his business is added to his profits on the rising market and 80 per cent thereof taken for E. P. Duty and 6*s.* in the £ on the Balance for Income Tax, but when on the falling market a loss arises, such difficulties have been placed in the way of proving a loss that it is a matter of almost complete indifference what period of time is given to send in claims.

The majority report of the committee deals with the technical difficulties of administering Rule 1 in the following manner:

The witnesses who came before us as representatives of industry considered this concession unworkable and wholly inadequate—unworkable because the physical identity of the stocks sold cannot in practice be ascertained; inadequate as only relating to one set of sales. The Board of Inland Revenue, we understand, hope to be able to overcome the first objection to the satisfaction of the trader. That is to say, a business will not be required to prove that the particular stock sold is that which was originally held. For example, if the stock at the end of the last accounting period was 1,500 tons, and 1,000 tons were sold in the succeeding two years, the concession would cover the whole 1,000 tons, whether they were part of the original 1,500 or not. Indeed, the official witness went further. He expressed the personal view that if the sales were only 1,000 tons during the two years the business should be allowed to take the remaining 500 tons at their market value at the end of the two years, and date back this loss just as if they had been sold.

We consider it essential when effect is given, by the promised statutory regulation, to the undertaking in the White Paper that these points should be clearly conceded.[126]

The second objection mentioned in this excerpt—that the relief applied only to one set of sales—raised issues which in the

[126] Cmd. 9224, p. 5.

opinion of the committee could not be met in an entirely satisfactory manner. The majority recommendation on this point was that, if possible, the rate of the tax be reduced from 80 per cent, where it then stood, to 60 or 65 per cent, "on the understanding that the rate so given up is retained in the business and not distributed."[127]

Such a reduction of rate "might well be accompanied by the withdrawal of the first undertaking provided in the White Paper (Rule 1), for the latter was, after all, largely consequential upon the raising of the Duty to 80 per cent."[128]

If the rate could not be reduced the committee recommended a highly ingenious plan for converting a portion of the Duty into a "suspensory reserve" in the form of a special type of government bond. The scheme is set forth in detail in the following quotation from the report:[129]

> 17. If, however, in the present state of the National Exchequer, the course we suggest [*viz.*, the reduction in the rate] is impracticable, and the actual cash must be available to the Government, we recommend that a portion of the Duty now to be paid be regarded not as a final payment of tax, but as a suspensory reserve, held on joint account by the Government and the taxpayer. The portion so reserved should be represented for the time being by a special kind of War Loan, which would be so held for five years. Thereafter this reserve would revert entirely to the State; or, in circumstances to be set out below, would become wholly or in part (with accrued interest) the property of the taxpayer.
>
> The advantages of this scheme are threefold:—
>
> 1. It affords tangible evidence to the taxpayer of a definite provision made by the State towards prospective post-war losses.
> 2. It fixes a maximum limit to the Exchequer's ultimate liability on account of such losses.
> 3. Capital experiences great difficulty in the financing of its business during this period of inflated prices. Relief is at present afforded by excess profits earned, but not paid in to the Government until eight or ten months after the close of the year under assessment, and by excess profits earned but not paid in during the running year. The existence of this reserve affords valuable collateral security, for it reassures the banker at the moment when anxiety is acutest, *i.e.*, when profits are declining to a critical figure.
>
> We suggest that the amount of this reserve should be 20 per cent of the *average* excess of profits above the standard in the last two

[127] *Ibid.*, p. 6.

[128] *Ibid.*

[129] *Ibid.*, p. 6 *et seq.*

years under the charge to Excess Profits Duty. (The Chairman and certain members of the Committee are of opinion that this percentage should be considerably greater.) When the last payments of Duty are being made, the scrip of the special war loan to which we have referred would be given for the sum so computed, and ordinary tax receipts for the balance.

The circumstances in which, as we suggest, the reserve should not revert finally to the Government, but wholly or in part to the taxpayer, are as follows:—

The taxpayer must show, at the end of five years after the war, that his average annual profits over that period are less than the amount of the *percentage* standard to which he was entitled, or would have been entitled, under the Excess Profits Duty, and that these deficiencies have been connected with holding stock at falling prices (as distinct, for example, from bad management or reduced turnover), during that period. He would then be entitled to relief to the extent of 80 per cent on those deficiencies, and the war loan, with accrued interest, would revert to him for the amount of that relief, but for no greater sum than the amount of the reserve. For example: A company has an excess profit of £40,000 in the last two years of the duty, or an average of £20,000. In its final payments to the Exchequer, 20 per cent, viz., £4,000, would rank as Reserve (under war loan).

Its profits standard, for Excess Profits Duty, was £15,000 (*i.e.*, its profits in 1912 and 1913), or, say, 15 per cent on its capital of £100,000. If, after the war, its average profit is £12,000, it has *no claim,* even though losses have been made at various times by sales on a falling market. But, if the profit falls below the percentage standard[130] (6 per cent on £100,000 = £6,000), and amounts, say, to an average of £5,200, it would get relief as follows:—

Five years' Profits	£26,000
Five years' Percentage Standard.....	30,000
Deficiencies	£4,000
80 per cent thereon.....	3,200

£3,200 of the £4,000 in suspense reverts to the taxpayer. If, however, the profits amounted, say, to an average of £4,000 only, it would get relief as follows:—

Five years' Profits	£20,000
Five years' Percentage Standard.....	30,000
Deficiencies	£10,000
80 per cent thereon.....	8,000
Relief confined to the sum in reserve.....	£4,000

[130] It will be necessary to consult the Treasury on the feasibility of the scheme.

It may be well to explain here why the relief proposed should not extend beyond 80 per cent of the deficiency. It will be obvious that if the deficiency ranked for relief in full, a trader, who found he was likely to be a claimant, would have no incentive to trade properly and keep his deficiency as small as possible, for the State would bear it all. We, therefore, consider that some incentive must be given him, which will, in effect, protect the State from such an abuse.

18. We do not pretend that the remedy we propose with the limit suggested meets all the possible or prospective losses on a falling market. But it is obvious that any relief must be limited and severely conditioned by the financial position of the Exchequer in the difficult years following the war, and by the burden that would be thrown upon other classes of taxpayers called upon to make good the charge to the Exchequer resulting from the relief. Hence, we cut out altogether from consideration all trading concerns which, though adversely affected by the fall in prices, still make relatively good profits, and deal only with those which are genuinely hard hit over an extended period, relieving them to an extent which pays more regard to the paramount needs of the Exchequer than to the degree of misfortune of the taxpayer. Any attempt to make the relations between the taxpayer and the State in the matter of relief on a falling market exactly parallel to and consistent with their relations in taxation during the war on a rising market, is not practicable; and, if it were practicable, does not commend itself to us as in itself an aim to be pursued.

* * * * * * * * *

21. It is not possible for our suggested remedy to have application simultaneously with that promised by the Government under Paragraph I of the White Paper; and we should accordingly have recommended but for one consideration, that the latter be cancelled. The Government undertaking relates to the losses upon *one set of sales,* viz., of the stock in hand at the end of the Excess Profits Duty, without regard to the general prosperity of the business in the long run. It may well be that businesses having a claim under the White Paper, on the faith of which they are now resting, will never even expect to be so depressed as to come within our proposal. We therefore suggest that undertakings given in the White Paper (made clear, as we recommend in paragraph 11) should stand; but that each business should state, when making its return for assessment for the last period, whether it proposes to come under the White Paper, or, waiving all rights thereunder, to come under the five-year war loan system of relief. This election is free from the objection which would attach to an option after the event.

A combination of factors, including among others the continued existence of the Duty itself, the reduction in the rate to a point even below that suggested by the committee and the failure of prices to collapse so violently as had been anticipated, has

operated to delay action on the report of this committee. However, a sharp fall in prices or an extended business depression is certain to bring the problem up again. It is generally understood that the present Government is practically committed to legislation giving further relief along the lines laid down in the report.

It is significant that the majority of this British Committee opposed the use of the "base-stock" method. Our own situation can probably best be relieved by a broad amendment recognizing all losses even when realized after the taxable period in question.

Capital Gains.—Since the British concept of taxable income does not ordinarily include profits derived from the sale of capital assets of a business,[131] "replacement funds" are superfluous.

Upon passage of the Act, however, it immediately became apparent that the failure to tax capital gains opened a wide avenue for those who desired to escape the tax. Appreciated assets could be sold in bulk or as a part of a going business without subjecting the resulting profit to tax. That appreciation might be due to lavish expenditures from current income for purposes such as advertising, deductible as an expense but contributing to the future as well as the present earning power of the business. Or the sale of the asset at the high level might be resorted to with the purpose of establishing a new standard of profits or high depreciation and obsolescence allowances. The problem here arising has not been fully met by the British authorities.[132] Its continued presence is condoned by the temporary character of the tax.

The 1916 Proposal to Tax Capital Gains.—Only a few months after the passage of the act Mr. McKenna asked for an amendment which would bring within the scope of the Duty "any sum by which the price given on the sale of any asset capable of producing profits exceeds the pre-war value of that asset."[133] He stated that this was needed "to prevent a leakage which might become serious."[134] A desire to reach the profits being made from the sale of ships was said to be the principal motive back

[131] *Cf. supra,* pp. 21-22.

[132] *Cf. supra,* p. 22.—The situation has, thus far, not become so serious in this country because capital gains are considered taxable income and the individual surtaxes have been high enough to discourage the consummation of such transactions. There may have been, however, some evasion of our Excess Profits Tax by this method.

[133] April 4, 1916, Debates, 81: 1160.

[134] *Ibid.,* 1052.

of the suggestion. In the debate strong objections were made to the proposal. It was pointed out that it was inconsistent with the income tax law and that if the gains were taxed, the deduction of capital losses would have to be allowed.[135] It was decided, finally, to attempt to reach the profits of shipping in a different and indirect manner through a modification of the pre-war standard.[136]

Profits Realized from Disposition of Trading Stocks.—The general problem again became acute in 1918 when it became known that certain Scotch distillers were evading the Duty by resort to capital transactions. Being in possession of large stocks of whiskey which had appreciated enormously in value and which would result in large profits subject to the 80 per cent Duty if sold in the ordinary course of trade, they succeeded in realizing on the stock without paying the duty by selling it in bulk otherwise than in the ordinary course of the business as a going concern.

The amendment of 1918[137] was aimed directly at this practice. It provided that for purposes of the Duty profits arising from the sale of trading stock at any time after April 22, 1918 (the date of the Chancellor's budget speech announcing the amendment), "otherwise than in the ordinary course of trade," would be "deemed to be profits arising from a trade or business." Where a business had ceased it was to be "deemed to have been carried on up to and including the date on which the sale takes place." In such cases the person by whose authority the stock is sold is made liable for the Duty. No liability attaches to the purchaser. The appointment of a liquidator or other agent to dispose of the stock is not treated as a change of ownership, the true owner's interest and liability carrying through to the consummation of the operation. Where trading stock is combined with other assets in a general sale the Commissioners of Inland Revenue[138] assign the portion of the profits for which the trading stock is responsible. Disposition of the stock otherwise than by sale, *viz.*, by exchange or by distribution *in kind* is held to be a realization and no such disposition was permitted after May 14, 1918 (the date of the announcement of this proposal in the House of Commons) without provision being previously made with the Commissioners

[135] *Cf.* speech of Sir S. Harmood-Banner. Debates, 81: 1089.

[136] *Cf. infra,* p. 80.

[137] Finance Act, 1918, sec. 35.

[138] With appeal to the Commissioners of Income Tax.

guaranteeing the payment of the Duty. Trading stock is so defined as to include raw and semi-finished goods as well as the completed product.

As the matter stands, consequently, there is this modification in the concept of profits so far as the inclusion of capital gains is concerned, *viz.*, that profits made from the disposition of assets which, if sold in the ordinary course of business, would become taxable are to be included when realized even though sold outside the ordinary course of trade.

Modifications Due to Variations in Value of Securities.—The problem of the effect of variations in the value of capital assets upon the profits subject to the Duty is again involved in the special modifications allowed in the profits of life insurance companies and concerns whose principal business consists of the making of investments on the ground of variations in the value of those investments. As has been pointed out, the Commissioners have been able to extend relief in certain cases where market values have shrunk owing to the general diminution in the purchasing power of money.[139]

Even more interesting is the procedure with reference to variations in the value of war bonds which are owned by a concern as a temporary investment and which have been recognized as invested capital.[140] In such cases both profits and losses resulting from the sale of such securities are taken into account in arriving at taxable profits.

Reasons for Exclusion of Capital Gains.—It is an occasion for wonder in this country, where so much of our wealth is accumulated through the appreciation of assets of one type or another, that the British should not tax capital gains. So far as the writer was able to learn from his inquiries, however, there is fully as much wonder among the British that we should undertake to tax such gains. No demand at all exists for a change in their practice. In fact, their concepts of capital and income, artificial though they appear to the American observer, are entrenched by a century of acceptance and are considered by the ordinary business man as natural as the laws of physics. Of course, the administrators are acutely conscious of the problem involved in the differentiation but their interest is primarily on the technical side

[139] *Cf. supra,* p. 42.

[140] *Cf. infra,* p. 85 *et seq.*

—that of establishing the dividing line for administrative purposes.

When one asks an Englishman why capital gains are not taxed the first reply is almost invariably a surprised and shocked exclamation to the effect that this would mean the taxation of capital and not of income. If one then asks whether a tax on the increased value of stock-in-trade is a tax on income or a tax on capital, he usually forsakes argument on the basis of fundamental principle and pleads the practical necessity for a dividing line. As a matter of fact that dividing line is a thin and tenuous one even in English income tax procedure as can be judged by some of the modifications, described above, which have been found necessary in the course of the administration of the Excess Profits Duty.

In practice the distinction between taxable capital gains and exempt capital gains is left to the local surveyor without any very definite rule to guide him. Moreover, the cases which have been carried to the courts have not been dealt with decisively, so there exists in practice a wide twilight zone within which cases are sometimes decided one way and sometimes another. One principle which the courts attempt to apply is that the purpose for which the asset was acquired is a material consideration.[141] If bought to resell, the profit is taxable. If bought and resold at a profit when the original intention was not to resell, the profit is exempt. It is apparent that, where the distinction rests in this fashion upon an ascribed motive which need not be declared until after the event, the distinction has no very firm foundation.

The fundamental explanation of the British concept is probably to be found in certain facts in the general economic background of England. It is an old, conservative, economic organism where transfers are less frequent than in this country, where fortunes are less often made through trafficking in appreciating assets, where values are dealt with more largely in terms of income and less in terms of sale price and where, above all, the general conception of the economic structure is static rather than dynamic. This is very well illustrated by the fact that a tax on capital gains is often seriously opposed on the ground that this would logically involve the allowance of capital losses the net result being no additional tax. The conception of a total increase

[141] *Cf.* California Copper Syndicate *etc.* vs. Harris, C. E. S. Fraser's Law Reports. Vol. VI, p. 894.

in national wealth appears to be not a part of the mental furniture of most Englishmen. The minor losses and gains would, they feel, merely cancel each other and, with their static conception of aggregate wealth, the game does not seem to be worth the candle. Especially do the British shrink from any tax which involves an extensive evaluation of property, an attitude which has been accentuated by the bitter experience of the Inland Revenue with the Land Values Duty.

Closed Transactions.—The problems encountered under our statute in sales of assets, exchanges of property, mergers, consolidations and reorganizations, are almost entirely absent from the British practice since there appreciations in the value of capital assets are not taxed.[142] They entirely avoid the difficult case of a taxpayer who receives, by selling his capital assets, an abnormal amount of income in one year (in comparison with his invested capital) due to the realization of profits which have gradually accumulated over a period of years. Here such cases are often so serious as to require special treatment under the relief provisions of the statute.[143]

Determination of the Pre-War Standard

The profits as determined along the lines laid down in the preceding section are compared with a standard to determine their excessiveness. The British standard of profits, although single in form is in effect a double one. The rate is applied to the profits in excess of the *pre-war standard.* This, the statute states, is to consist of the *profits standard* except when "it is shown to the satisfaction of the Commissioners of Inland Revenue that that amount was less than the *percentage standard*" in which case the latter was to prevail.[144] The option, it will be observed, operates in favor of the taxpayer and against the Treasury.

The term *pre-war standard* consequently refers sometimes to a profits standard and sometimes to a percentage standard. These expressions are used in their technical sense in the discussion which follows.

The Profits Standard.—The Profits Standard, which is used in at least 80 per cent of the assessments, is defined as "the amount

[142] *Cf. supra,* p. 69 *et seq.*

[143] Revenue Act of 1917, sec. 210; Revenue Act of 1918, sec. 328.

[144] Finance (No. 2) Act, 1915, sec. 40 (1).

of the profits arising from the trade or business on the average of any two of the three last pre-war trade years, to be selected by the taxpayer."[145] Profits for these pre-war years are computed "on the same principles and subject to the same provisions as the profits of the accounting period."[146] "The last pre-war trade year" is construed to mean "the year ending at the end of the last accounting period" before the outbreak of the war.[147]

In place of the average of two of the three last pre-war trade years, the statute permits the substitution of an average of any four of the six last pre-war trade years whenever the taxpayer can satisfy the Commissioners of Inland Revenue that the three year period was one of "abnormal depression." This phrase is defined to mean that the average of the three last pre-war years must "have been at least 25 per cent lower than the average profits of the preceding three years."[148]

Our 1917 law, which contemplated a deduction of the average pre-war earnings from the profits of the taxable year (but not less than 7 per cent or more than 9 per cent), required the average of the three years, instead of any two of such years. The 1918 law maintained the same rule for the war profits tax.

A bad pre-war year, in which there were very low earnings or a loss, is eliminated from the British computation of pre-war profits. With us the bad year would be included, but if the year showed a loss, the earnings of the two good years were divided by three. The British arrangement is decidedly more liberal to the taxpayer.

When Pre-War Period is Short.—The use of the profits standard was made available to concerns which had begun business too late to have acquired a record of three pre-war trade years within the following limitations:

1—Where there have been but two pre-war trade years, the taxpayer has the option of the last or the average of the two,[149] and

[145] Finance (No. 2) Act, 1915, sec. 40 (2).

[146] *Ibid.*, Fourth Schedule, Part II, rule 1.

[147] *Ibid.*, sec. 40 (2).

[148] *Ibid.*, Fourth Schedule, Part II, rule 3.

[149] A deputation from the Association of Chambers of Commerce of the United Kingdom asked for an amendment in 1917 which would permit a selection of either one of the two years, but the request was ignored. Deputation. April 24, 1917, pp. 3-4.

2—Where there has been but one, the profits of that year are taken as the profits standard.

In cases where there has not been a full pre-war trade year the pre-war standard is not a profits standard at all, but is taken to be "the statutory percentage on the average amount of capital employed in the trade or business during the accounting period."[150]

In New Agencies, Etc.—The difficult case of the recently established agency or business involving capital of such relatively small amount that the percentage standard offered nothing substantial in the way of relief is met in the statute by a provision granting a special profits standard. In such cases the pre-war standard is "computed by reference to the profits arising from any trade, business, office, employment or profession of any sort, whether liable to Excess Profits Duty or not, carried on by the agent or other person, before his new trade or business commenced as if it was the same trade or business; but only to the extent to which the income from the former trade, business, office, employment or profession has been diminished."[151]

Our 1917 law was designed to avoid this problem by allowing a very liberal specific exemption; by taxing concerns having only nominal capital at a low, flat rate, and by special assessments based on a comparison of the taxpayer with representative concerns. The restriction of the application of the latest American law to corporations only and the exemption of "personal service corporations" from the tax, has practically eliminated this problem in this country.

In Certain Concerns with Pre-War Losses.—An important relief provision included in the Finance Act of 1917[152] applied to cases where several distinct and separate industries are carried on under one management but with separate establishments and records. The Commissioners, in computing the profits standard for such concerns, are permitted to ignore a loss sustained by one or more of the constituent industries in a pre-war year whose record was utilized in the standard.

Under our laws the rule is to take the net income of the whole

150 Finance (No. 2) Act, 1915, Fourth Schedule, Part II, rule 4. *Cf, infra,* p. 76.

151 *Ibid.*

152 Sec. 26 (5).

business, including all establishments and branches and including all subsidiary corporations in case of consolidated returns, making due allowance for all losses in reaching the net income for the pre-war period.

The Percentage Standard.—As an alternative to the profits standard there is the percentage standard defined in the statute as "an amount equal to the statutory percentage[153] on the capital[154] of the trade or business *as existing at the end of the last pre-war trade year.*"[155]

Thus from the very beginning the British Duty has depended to an appreciable extent upon invested capital as a standard and there has been a progressive increase in that dependence with each year because of new business concerns launched and new capital invested in old concerns.

The percentage standard is the only one available under the statute in cases where there has been less than one pre-war trade year. In such cases the standard is established by applying the statutory percentage to the "average amount of capital employed in the trade or business *during the accounting period.*"[156]

The statutory percentage was originally 6 or 7 per cent for all purposes, the lower rate applying to corporations. In 1917 the 7 per cent applying to unincorporated businesses was increased to 8 per cent and the term statutory percentage differentiated in its application. It was now made different in its amount (to the extent of 3 per cent) when used for calculating the percentage standard on old capital from what it was when used for making calculations on the basis of capital introduced since the outbreak of the war. As it stands today, consequently, the percentages used for establishing the percentage standard are 6 and 8 per cent in the case of capital invested in the business at the end of the last pre-war trade year and 9 and 11 per cent in the case of new capital,[157] plus any additional percentages allowed as the result of appeals.[158]

[153] *Cf. infra,* p. 91 *et seq.*

[154] *Cf. infra,* p. 80. Invested capital is separately treated because of its importance and because it is utilized for other purposes than the establishment of the percentage standard.

[155] Finance (No. 2) Act, 1915, sec. 40 (2).

[156] *Ibid.,* Fourth Schedule, Part II, rule 4.

[157] *Cf. infra,* pp. 91-93. It is proposed to raise the 9 and 11 per cent to 10 and 12 per cent in the 1920 Finance Act.

[158] *Cf. infra,* p. 130 *et seq.*

Since the statutory percentage is used in making modifications in the profits standard as well as in the percentage standard it is treated more fully in an independent section.[159]

Modifications of the Standard.—The pre-war standard is subject to a variety of modifications when special circumstances are present.

Modifications of "Rules" by Commissioners or Referees.—The taxpayer may apply to the Commissioners of Inland Revenue for modification of any of the rules relating to the standard contained in the Fourth Schedule,[160] which include those governing the establishment of the standard, in case there has been a change in the constitution of a partnership or in case of "any other special circumstances specified in regulations made by the Treasury."[161] If the Commissioners refuse to grant his application he may appeal to the Board of Referees.[162]

Modifications in Standard by Referees.—Moreover, in the following two cases of appeals for modifications in the standard, the Commissioners are without original authority and must automatically transmit the petition "unless they are of the opinion that the application is frivolous or vexatious or relates to matters already decided by the Board of Referees.":[163] applications

1—For an increase in the statutory percentage or for a calculation of the percentage standard in the case of any class of trade or business in which the amount of capital actually employed is small compared with the capital necessarily at stake; or

2—"For an alteration in the pre-war standard of profits as respects capital employed for the purpose of the manufacture of war materials or for munitions work and which could not be expected to be remunerative or fully remunerative, except in time of war, in a business which has been wholly or mainly carried on for those purposes."[164]

The action of the Board of Referees with regard to increases

159 *Cf. infra,* p. 91 *et seq.*

160 *Cf. infra,* Appendix A, II.

161 Finance (No. 2) Act, 1915, sec. 40 (3).

162 *Cf. infra,* p. 121 *et seq.*

163 Under an amendment included in the Finance Act of 1917 (sec. 25) the Commissioners may transmit such a petition even though it may relate to matters already decided.

164 *Ibid.,* sec. 42.

in the statutory percentages is treated in another place (*infra*, p. 121 *et seq.*).

Allowances for Increases or Decreases of Invested Capital.—Under the provisions of the American law the excess profits credit is established by applying the statutory rate to the invested capital "*for the taxable year.*"[165] In 1918, when the "war-profits credit" was available as an alternative, that credit was established by adding to or subtracting from the pre-war profits a sum equal to ten per cent of the capital invested in or withdrawn from the concern since the pre-war period.

The British modifications to take into account changes in invested capital are just as truly modifications in the pre-war standard but for the sake of simplifying the procedure the adjustments are made by adding to or subtracting from the taxable profits of the current accounting period rather than by changing the pre-war standard itself. The pre-war standard, ordinarily either the average profits of certain pre-war years or the statutory percentage of invested capital, remains precisely as it was, not in the taxable year, but *at the end of the last pre-war trade year.* Then, if capital has been added to the business or withdrawn from it the proper sum is subtracted from or added to the profits of the current accounting period to compensate for the change.

Where capital has been increased a deduction is made from the profits of the accounting period equal to 9 per cent in the case of corporations and 11 per cent in the case of other businesses "on the amount by which the capital has been increased."[166] Where capital has been decreased, an addition is made to the profits of the period equal to 6 per cent, in the case of corporations, and 7 per cent, in the case of other businesses, on the decrease.[167]

[165] Revenue Act of 1918, sec. 312. There is a specific exemption of $3000 and the rate is 8 per cent.

[166] Finance (No. 2) Act, 1915, sec. 41 (1) as amended by Finance Act, 1917, sec. 26 (1). Before 1917 the rates were 6 and 7 per cent. This provision is inoperative in the case of the purchaser of a ship under certain conditions, Finance Act, 1916, sec. 47 (e).

[167] Finance (No. 2) Act, 1915, sec. 41 (2); Finance Act, 1917, sec. 26. For an explanation of the differences between the rates applied to the amounts of the increases and decreases, *cf. supra*, p. 14. A further adjustment is made in case the capital is changed during the course of the year rather than at the beginning.

Capital is determined to have increased or decreased by comparing the capital employed in the current period with

1—"the average amount of capital employed during the pre-war trade years or year by reference to which the profits standard has been arrived at," in cases where the pre-war standard is a profits standard, or

2—"the capital on which the percentage standard has been calculated" in cases where the percentage standard is used."[168]

Capital put into the business after these dates and withdrawn or lost before the current accounting period is ignored.

Modification for Capital Non-Remunerative before the War.—An adjustment of considerable importance which has no counterpart in our procedure is that which is made in the profits standard because of capital which while invested in the business prior to the outbreak of the war became remunerative, or fully remunerative only after that time. The statute reads:[169]

"Where any capital employed in a trade or business which was so employed for the first time within three years [increased to six years in 1917][170] before the first day of August, nineteen hundred and fourteen, has only commenced to be remunerative or fully remunerative in the accounting period, an amount equal to the statutory percentage (6 and 8 per cent) or where interest has been earned on the capital, but at a rate less than the statutory percentage, an amount which would bring the interest earned on the capital up to the statutory percentage, as the case may be, shall be added to the profits standard."

No adjustment is required for capital "ploughed into the business" in a year subsequent to the pre-war period and still unremunerative during the accounting period.

Standard in Case of Change in Ownership of Business.—Where there has been a change in the ownership of a business after the commencement of the three last pre-war trade years, the owner is given the option of proceeding as though the concern were a new one (in which case he could ordinarily secure recognition of the purchase price as invested capital) or of adopting the stan-

[168] Finance (No. 2) Act, 1915, sec. 41 (3). For a discussion of invested capital for use in connection with the calculation of the percentage standard, *cf. infra,* p. 80 *et seq.*

[169] *Ibid.,* sec. 41 (4).

[170] Finance Act, 1917, sec. 26 (7).

dards of the old business as those of the new.[171] No such optional arrangement obtains under our law.

Modifications of Pre-War Standard in Case of Shipping.—The authorities found that in the case of shipping a considerable leakage was likely to develop[172] because of the fact that profits from the sale of ships were not ordinarily considered taxable under the English law. Consequently they introduced a special section in the 1916 Finance Act.[173] which attempted to meet the situation indirectly through a modification of the pre-war standard. This clause provided substantially that, in the case of a ship sold after the beginning of the war, the profit not being subject to tax, the Commissioners of Inland Revenue might insist that the pre-war standard of the ship before the sale be passed on with the ship to the purchaser. This would be expected in most cases to increase the tax liability of the purchaser and reduce the price at which the sale took place. The government in effect foregoes a possible tax on the prospective operating profits subsequent to the sale. In any case, the section shuts off possible evasion through the device of inflating invested capital by selling one's ships and replacing them by others, the exchanges both taking place on a high price level.[174]

Determination of Invested Capital

Invested capital as determined under the British rules is very much the same thing as when determined under our rules. In both cases, "proprietor's capital" is the fundamental concept. Unrealized appreciations are not recognized and borrowed money is excluded in both statutes. The chief differences are two: first, the British take a narrower view of what constitutes investment

171 Finance (No. 2) Act, 1915, Fourth Schedule, Part II, rule 1. In case the old standard is retained, the basis of computation of the profits for the current year must be the same as that of the pre-war years. It should be noted that the substitution of assets is not considered a change of ownership. *Ibid.*, rule 6.

172 *Cf. supra,* p. 69 *et seq.*

173 Sec. 47. For the details, *cf. infra,* Appendix A, III. A provision in the 1915 statute (Fourth Schedule, Part II, rule 6), aimed to prevent avoidance of the Duty by single-ship companies, was rendered virtually inoperative by this section.

174 Insurance money received from lost ships is not recognized in such a manner as to reduce the Excess Profits Duty which would be normally payable.

in the business, excluding everything in the nature of securities owned by the concern, and bank balances above the amount required for the purposes of the business, and, second, they ignore the liability side of the balance sheet and build up their invested capital by dealing entirely in asset items, excluding written-off depreciation or lost assets from the computation. In this country, the sum originally invested constitutes an irreducible minimum.

The British practice in refusing to recognize "outside" investments as capital invested and their refusal to grant wide exemptions from taxation to the purchasers of their war bonds, has simplified the calculation of invested capital in certain respects and complicated it in others.

Invested Capital—When Utilized in British Procedure.—Invested capital plays a much greater rôle in British procedure than is generally realized. This concept is utilized under the following specific circumstances:

1—As the basis for the establishment of the percentage standard. This standard, which is resorted to whenever its use will result in a lower charge against the taxpayer, is established by applying the statutory rate (ordinarily 6 and 8 per cent) to invested capital at the end of the last pre-war trade year.

2—As the basis for adjustments in the profits of the current year because of increases or decreases in the amount of capital invested since the outbreak of the war. Such adjustments (amounting ordinarily to 9 or 11 per cent of the new capital introduced and 6 or 8 per cent of the old capital withdrawn) are made whether the profits standard or the percentage standard is used. Moreover, not only must the amount of the new capital introduced or the old capital withdrawn be calculated, but in order to make the computation it is necessary to determine the total amount of invested capital both for the current accounting period and for a point in time before the outbreak of the war. In case the profits standard is used, the pre-war invested capital is taken to be the average capital employed during the pre-war year or years. In case the percentage standard is used the pre-war invested capital is taken ordinarily to be the amount employed at the end of the last pre-war trade year.

3—As the basis for the establishment of a standard in the case of a concern which was not in existence for at least one year before the war. In such a case no profits standard is available as an option and the pre-war standard is simply taken to be the statutory percentage (ordinarily 9 and 11 per cent) applied to the average amount of capital employed during the accounting period.

It is apparent that there is scarcely an assessment into which invested capital does not enter. It must be calculated, at least roughly, in every case, but because of the practice in cases of increases or decreases of capital of making adjustments in current profits, the pre-war invested capital, once calculated, need not afterward be disturbed.

Rules Governing the Calculation of Invested Capital.—The British rules governing the calculation of invested capital are here quoted in full:[175]

1. The amount of the capital of a trade or business shall, so far as it does not consist of money, be taken to be—

(a) so far as it consists of assets acquired by purchase, the price at which those assets were acquired, subject to any proper deductions for wear and tear and replacement, or for unpaid purchase money; and

(b) so far as it consists of assets being debts due to the trade or business, the nominal amount of those debts subject to any reduction which has been allowed in respect of those debts for income tax purposes, and

(c) so far as it consists of any other assets which have not been acquired by purchase, the value of the assets at the time when they became assets of the trade or business, subject to any proper deductions for wear and tear or replacement.

Nothing in this Part of this schedule shall prevent accumulated profits employed in the business being treated as capital.[176]

2. Any capital the income on which is not taken into account for the purposes of Part I of this Schedule, and borrowed money or debts, shall be deducted in computing the amount of capital for the purpose of Part III of this Act.

3. Where any asset has been paid for otherwise than in cash, the cost price of that asset shall be taken to be the value of the consideration at the time the asset was acquired, but where a trade or business has been converted into a company and the shares in the company are wholly or mainly held by the person who was

[175] Finance (No. 2) Act, 1915, Fourth Schedule, Part III.

[176] They are not treated as capital during the period when accumulated, however. Finance Act, 1916, sec. 52.

owner of the trade or business, no value shall be attached to those shares so far as they are represented by good will or otherwise than by material assets of the company unless the Commissioners of Inland Revenue in special circumstances otherwise direct. Patents and secret processes shall be deemed to be material assets.

With one slight exception, the addition of a clarifying statement regarding accumulated profits,[177] these rules have stood without modification since the passage of the law in 1915.[178]

Borrowed Money Excluded from Invested Capital.—As is the case in our law, the British statute excludes borrowed money from invested capital; "any borrowed money or debts" are deducted,[179] as is also any "unpaid purchase money" on assets.[180]

The British authorities have serious doubts regarding the soundness of this policy. They are inclined to believe that a more equitable tax would result if borrowed money were included in invested capital and interest on such sums deducted from tax-

177 Finance Act, 1916, sec. 52.

178 In this country invested capital, under the Revenue Act of 1918 means:

(1) Actual cash paid in for stock or shares.

(2) Actual cash value of tangible property, other than cash, paid in for stock or shares, irrespective of the par value of the shares, the excess over such par value being treated as paid-in surplus.

(3) Paid-in or earned surplus and undivided profits.

(4) Intangible property (patents, trade-marks, good will, etc.) to an amount not to exceed the lowest of these values—

(a) the actual cash value at the time paid in,

(b) the par value of the stock issued therefor, or

(c) 25 per cent of the par value of the outstanding shares of stock on March 3, 1917, in respect of all intangible property paid in prior to that date and 25 per cent of the par value of the stock outstanding at the beginning of the taxable year in respect of all intangible property acquired after March 3, 1917.

Intangibles acquired with cash are fully recognized. For more detailed statement *cf.* Revenue Act of 1918, secs. 325-326.

The Revenue Act of 1917, differed in several respects: (a) it allowed as invested capital the value on January 1, 1914, of tangible property paid in for stock prior thereto, provided such value did not exceed the par value of the stock originally issued for such property; (b) it made a distinction between patents and other intangible property, allowing with respect to patents the cash value at the time paid in but not exceeding the par value of the stock issued therefor. A limitation of 20 per cent of the stock outstanding on March 3, 1917 applied to good-will, trade-marks, *etc.* For details see Revenue Act of 1917, section 207.

179 Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 2.

180 *Ibid.*, rule 1.

able profits. They have no solution, however, for the problem of drawing a line of distinction between permanent and temporary debt or for taking into account the intangible element of personal credit.

Profits Accumulating During the Current Accounting Period.—The original statute recognized as invested capital "accumulated profits employed in the business"[181] as reflected in asset values. A clarifying amendment in 1916 specifically ruled out profits accumulating during the accounting period.[182] British and American statutes are in accord on this point.[183] However, the British practice of permitting returns for accounting periods of less than twelve months provided a method by which recognition of accumulated profits can be more speedily obtained. The concern which secures this earlier recognition, however, must pay its tax sooner than the concern which does not and the net effect is favorable to the taxpayer only when the continued possession of the tax money is less valuable to him than credit obtained through the application of the statutory percentage (9 or 11 per cent, normally) to the new capital. Moreover, in actual practice the British do recognize as invested capital profits accumulated in a current accounting period, in so far as a fixed investment in capital assets is made out of such profits.

"Inadmissible" Assets.—The British statute declares that "any capital the income on which is not taken into account for purposes of the Duty shall be deducted in computing invested capital."[184] This has the effect of excluding investments made by business concerns whose principal business does not consist of making such investments.[185]

The section quoted above is that which corresponds closely to our section defining "inadmissible assets,"[186] but the British are

181 Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 1.

182 Finance Act, 1916, sec. 52.

183 Revenue Act of 1918, sec. 326. Under our 1917 statute the Treasury did allow the inclusion of such earnings in the case of individuals. It is possible that our courts would hold that, under the language of the Revenue Act of 1917, current earnings invested in fixed assets during the year should be included in invested capital from the date of such investment, notwithstanding the Treasury rulings to the contrary.

184 Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 2.

185 *Ibid.*, Part I, rule 8.

186 Revenue Act of 1918, sec. 325 (a).

spared the trouble of specifying the conditions under which inadmissible assets shall change their stripes and be admitted, after all, to the computation of invested capital. Here such readmissions must be permitted because (1) taxable profits may have been derived from the sale of such assets in certain cases, or (2) in order to carry tax-exempt securities the concern has paid interest on borrowed money which is not deductible in calculating net income. In England they do not ordinarily tax gains through appreciation of capital. Neither do they have tax-exempt securities in important quantities nor, consequently, limitations on the deduction of interest on money borrowed to purchase or carry such securities. Their problem is comparatively uncomplicated and simple.

In our Revenue Act of 1917 appeared somewhat conflicting provisions as to the deduction from invested capital of borrowed money (from the liability side of the balance sheet) and inadmissible assets, that is, assets the income from which was not subject to the excess profits tax (from the asset side of the balance sheet). The conflict was reconciled by practically assuming that the inadmissible assets were acquired with the borrowed money and a deduction from the assets was required only to the extent that the inadmissible assets exceeded the borrowed money. The Revenue Act of 1918,[187] contains a much more complicated provision based on the principle that the capital and the borrowed money shall be considered to be invested in all assets in proportion. Thus:

Admissible assets ...	$100,000	Capital	$100,000
Inadmissible assets..	100,000	Borrowed money....	100,000

will give the taxpayer $100,000 invested capital under the Revenue Act of 1917 but only $50,000 invested capital under the Revenue Act of 1918.

The British practice in this respect is to consider each case in the light of its particular facts; to include or exclude investments on the consideration of whether or not the money so invested is properly held for the uses of the business and only temporarily invested in outside securities. Borrowed money is allocated to the investment assets or the business assets according to the facts in each particular case. Where the statutory percentage deduction is low (6 per cent on invested capital) it seems

[187] Sec. 326 (c).

the question is not deemed to be very important. Where the statutory percentage deduction has been raised by the Board of Referees the question of inclusion or exclusion of investment assets or the allocation of borrowed money is generally considered to be a matter for special ruling by the Commissioners.

The British are much more strict than we are in that they decline to recognize as invested capital any resources which are not used directly in the business or will not soon be so used. In this country the resources owned by the corporation are much more freely recognized, whether they be investments in other businesses, government bonds, or bank deposits.[188] In some cases the assignment of idle bank balances or investments in securities to corporations for use as invested capital has reached the proportions of an abuse. The recognition of our government bonds as invested capital, even when the income from those bonds need not be included in taxable profits[189] is an indirect bonus whose proportions are but faintly realized.

In Great Britain all investments by a business outside the concern itself are eliminated from invested capital, except when it can be shown that the investment is essentially temporary in its character and that the money will be needed for purposes of the business[190] in a short time, the period usually being set at one year. This rule applies to investments in Government securities[191] and to bank deposits as it applies to other investments. It has been insisted upon in some border-line cases in which the investment was very closely related to the purposes of the business in question. For example, a coal agent was refused permission to include in his invested capital investments which he had made in certain collieries with the purpose of securing the agency business involved in the disposition of the output of the collieries.

Accrued Taxes as Invested Capital.—The British practice is to regard the amount of income tax and excess profits tax as a liability from the date the tax is payable, and to require a deduction from invested capital of such amounts in computing the capital at that date.

188 *Cf. supra,* p. 12.

189 Revenue Act of 1918, sec. 325 (a).

190 In cases where the investment is excluded from invested capital, the income, of course, is deducted from taxable profits.

191 However the commissioners have not applied this rule so as to reduce, in effect, the pre-war invested capital of a concern.

Effect of Depreciation and Depletion upon Invested Capital.—The British practice with regard to deductions from profits for depreciation has been fully discussed in another place.[192] It only remains to consider here what effects these deductions, whose very allowance implies a diminution in value of the invested asset, have upon the invested capital of the concern for purposes of the Duty.

It will be recalled that the British build up their concept of invested capital from the items on the asset side of the balance sheet and do not avail themselves of the principle incorporated in our law which regards as inviolate the amount of capital originally invested in the business. The most important difference between the British and the American practice with respect to depreciation in relation to invested capital rests on this distinction. Here a concern's invested capital does not sink below the level of the original investment as represented by the item on the liability side of the balance sheet consisting of money or property (under certain limits) paid in for stock. It does not sink below that level for purposes of our tax even though the value of the total assets of the business have actually shrunk below that amount through the fact that depreciation has been inadequately provided for or the fact that depreciation funds have been lost or dissipated. In Great Britain, on the other hand, the allowance of a given deduction for depreciation involves automatically a reduction in invested capital as of the end of the period when the deduction is made without regard to any limitation such as the amount of the original investment. The statute merely says "assets . . . subject to any proper deductions for wear and tear or replacement."[193] Quantitatively the whole point is unimportant.

While it is true that the sum set aside for depreciation reserve is recognized as invested capital when used to purchase additional assets for the business, it is not so considered if it is invested outside the business. In this country we do not discriminate between investments within and without the business so long as the ownership of the capital continues with the concern.

It is interesting to note, however, that the British will recognize deductions from profits because of postponed renewals or repairs without insisting upon a corresponding reduction in the value of the asset for purpose of invested capital.

192 *Cf. supra,* p. 48 *et seq.*

193 Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 1 (a and c).

The narrowness of the depreciation and depletion allowances[194] permitted under British income tax procedure reflects itself in invested capital. As has been seen, ordinary depreciation has been deductible only in the case of plant and machinery of business concerns. The general rule is that such deductions are proper only when the asset has diminished in earning power or when the expenditure on repairs has increased with the age of the asset. Of course if exceptional depreciation is applied for and secured (and such appeals are decided on the basis of individual applications), the deductions must be eliminated from invested capital. However, the situation is such that many assets, which in this country would be reduced in value [195] whether depreciation had been charged off by the concern or not, continue to appear in English calculations of invested capital at the full amount of their original cost.

The non-allowance of depletion under the income tax[196] has a marked effect upon the invested capital of mining and similar concerns. It is possible for them to continue to use as invested capital the full original cost of the property up to the time when the last bit of ore is extracted. The allowance for depletion for purposes of the Excess Profits Duty, which is indirectly given through the increased statutory percentage does not operate in such a manner as to reduce the amount of the figure representing capital invested. Patents, also, are included at their full value on the theory that their earning power remains unlimited until expiration.

Losses Through Bad Debts Deductible from Invested Capital.—The British deduct their losses for bad debts, when arriving at taxable income for income tax purposes, not, it is true, through the deduction of reserves for bad debts, but rather through the device of evaluating the debts due the business at the end of the period and charging off the estimated shrinkage, which amounts to very much the same thing so far as stabilizing annual losses is concerned. In constructing their invested capital for Excess Profits Duty purposes, the nominal amount of debts due the business is "subject to any reduction which has been allowed in respect of debts for income tax purposes."[197]

194 *Cf. supra,* p. 48.

195 Except for the limitation of the total original capital.

196 *Cf. supra,* p. 55 *et seq.*

197 Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 1 (b).

In this country a bad debt is not deductible until the loss is actually established; no reserves for bad debts are recognized for income tax purposes. This has the effect of making it possible for a concern which nevertheless maintains a reserve for bad debts to carry that reserve to surplus at the beginning of the taxable year and utilize it as invested capital for the entire year.

Of course, if an English concern realizes more on a debt than its appraised worth, it will become taxable on the difference and the profits so increased will be measured by an invested capital standard which has been diminished by the amount of the under-appraisal. In this country such a concern would be given an invested capital standard based upon the nominal value of the debt and, in case part or all of it failed to materialize later, it would be free to deduct the loss from its profits. Take the case of a $20,000 debt arising in 1919 which is appraised at 50 per cent at the end of the year. The English concern would be taxed on a profit smaller by $10,000 than the American because the American could not deduct its reserve for the bad debt. But the English concern's invested capital would immediately drop by the amount of the $10,000. Next, suppose that after all the $20,000 debt is paid during the year 1920. The English concern is taxable upon $10,000 in that year but now has an invested capital which is smaller by $10,000 than that of the American concern.

Certain Losses Recognized as Invested Capital.—The Finance Act of 1917[198] gave the Commissioners special powers in computing the invested capital of concerns where, due to trading losses suffered during the six pre-war trade years, former assets had ceased to form part of the assets of the business or the indebtedness of the concern had increased. In such cases the commissioners may establish their invested capital "as though there had been no such loss of assets or increase of borrowed money or debts." There is no provision in our statute which corresponds to this precisely but our arrangement whereby invested capital is not reduced below the amount originally "sunk" in the business should be borne in mind in making comparisons.

Valuation of Assets Acquired by Exchange.—The general rule for valuing an asset which has been paid for otherwise than in cash is "the value of the consideration at the time the asset was

[198] Sec. 26 (6).

acquired,"[199] but this is subject to the restriction in case of stock received for good-will in certain incorporations.[200]

Good-Will and Patents.—Good-will is recognized as invested capital when paid for either in cash or in stock except that when individuals incorporate their business, receiving stock for their good will the transaction is not countenanced. The rule governing this exception reads as follows:

> "Where a trade or business has been converted into a company[201] and the shares in the company are wholly or mainly held by the person who was the owner of the trade or business, no value shall be attached to those shares so far as they are represented by good-will or otherwise than by material assets of the company, unless the Commissioners of Inland Revenue otherwise direct. Patents and secret processes shall be deemed to be material assets."[202]

Good-will, however, is so defined as to exclude patents and secret processes. These are deemed to be tangible property (material assets). Trade marks and trade names are considered to bear a close relation to good-will, although it is recognized that no distinct line can be drawn easily between these and patents. Under any special circumstances, therefore, the Commissioners of Inland Revenue may rule specifically.

The restrictive provision in the British Act as to recognizing good-will in the case of incorporation is strictly construed and unless the shares of the new company are wholly or mainly held by the person who was the owner of the former business, value is allowed to be placed on the good-will. Thus, in one case where the husband had been the owner of the business and on incorporation the wife received a large part of the shares allotted for good-will, the value of the good-will was allowed as invested capital of the company. Moreover, "wholly or mainly" as used in the statute is interpreted to mean about 95 per cent.

The treatment of expense of creating good-will presents an interesting feature of the British practice. In one case it appears

[199] Finance (No. 2) Act, 1915, Fourth Schedule, Part III, rule 3.

[200] *Cf.* following paragraph.

[201] The provision giving the new concern the option of the standard of the old concern or the percentage standard on its own invested capital is applied in practice to "amalgamations," a term corresponding roughly to our reorganizations.

[202] *Ibid.*

that a company had losses in the first five years of its existence amounting to a considerable sum, carried on the asset side of the balance sheet as "Profit and Loss Account." This was considered practically to represent an expenditure for good-will, although not so called, and to be properly allowable as invested capital.

The British practice of declining to recognize good-will as invested capital in cases of certain incorporations, narrowly confined though it is in its application, has been the cause of considerable inequality. The British have made little effort to alleviate the situation because of the temporary character of the tax.

However, the British restriction is trifling and insignificant compared with the rigid, arbitrary 25 per cent limit applied to intangibles by our law.[203] Patents, it will be recalled, are classified as intangibles along with good-will and made subject to the limit. In Great Britain patents and secret processes fall entirely outside their very moderate limitation.

The Statutory Percentage

General.—In the original act the statutory percentage was made "6 per cent in the case of a trade or business carried on or owned by a company or other body corporate, and 7 per cent in the case of any other trade or business."[204] In accounting periods ending on or after January 1, 1917 (on which date the 80 per cent rate came into effect), the 7 per cent was increased to 8 per cent.[205] From the same date other increases were made effective, in so far as the rate was used for certain particular purposes. Thus the general statutory percentages of 6 and 8 per cent were increased by 3 per cent (to 9 and 11 per cent) first, when used to ascertain "the deduction to be made from the profits of the accounting period in respect of increased capital," or second, when used to ascertain "the pre-war standard of profits in cases where there has not been one pre-war trade year."[206] It is proposed in 1920 to make these rates 10 and 12 per cent.

It is particularly worthy of note that the amendment of 1917 specified the use of the increased rate in the calculation of the deduction to be made from the profits of the current period in respect of increased capital without its application to the calcu-

[203] Revenue Act of 1918, sec. 326 (4 and 5).
[204] Finance (No. 2) Act, 1915, sec. 40 (2).
[205] Finance Act, 1917, sec. 26 (2).
[206] *Ibid.*, sec. 26 (1).

lation of the addition to be made in respect of decreased capital.[207] That is, the theory behind the changes was (1) that a greater differentiation should be made between incorporated and unincorporated business (hence the increase from 7 to 8 per cent) and (2) that capital invested since the outbreak of the war should be given a greater allowance than that invested earlier (hence the additional 3 per cent in the two cases specified).

The differentiation between incorporated and unincorporated businesses of 1 per cent before January 1, 1917, and 2 per cent, thereafter, was designed to compensate for the advantage possessed by the incorporated concern with respect to the fact that they are permitted to deduct salaries of managers in determining their profits.[208]

The following tabulation summarizes the standard percentages as they now stand:

STATUTORY PERCENTAGE

Accounting periods ended after 31st December, 1916. Not including increases by the Board of Referees.

Purposes for which Percentage is applicable	Company or other body corporate	Any other trade, or business
Percentage Standard where optional with Profits Standard	6	8
Percentage Standard (obligatory) where there has not been one pre-war year	9	11
Deduction from profits of Accounting Period where capital has been increased	9	11
Addition to profits of Accounting Period where capital has been decreased	6	7
Addition to Profits Standard where capital has been unremunerative or not fully remunerative	6	8

Applications for Increase.—The Finance Act of 1915 specified that the statutory percentage then established, 6 and 7 per cent, should be subject to increase in certain cases upon appeal.[209]

[207] Finance Act, 1917, sec. 26 (2).

[208] *Cf. supra,* p. 14. A similar situation in this country during the year 1917, when the excess profits tax applied to partnerships and individuals, was met by permitting concerns which had made no deductions for salaries to charge off an equitable amount which varied from case to case. It was interesting to find that the British regard this as impossibly arbitrary procedure. Yet we regard the degree of power delegated to their administration as alarmingly great!

[209] Finance (No. 2) Act, 1915, sec. 40 (2).

The increased rates which went into effect on January 1, 1917, were specifically stated to be in addition to any special increases granted as the result of such appeals.[210] A full treatment of the process and results of appeals for increases in the statutory percentage will be found in connection with the discussion of Appeals on page 115 *et seq.*

ADMINISTRATION—GENERAL

Importance of Good Administration Recognized.—The English appear to realize more keenly than do we in this country the fundamental importance of good administration of tax laws generally and particularly of a law such as the Excess Profits Duty which requires the very finest ability in analyzing the accounts and making the complicated adjustments. The establishment of the Duty was delayed some time until assurances could be given that the administration could be properly cared for. In introducing the measure Mr. McKenna displayed a lively appreciation of the fact that the success of the tax depended upon the quality of the administration. As he contended, the question of increasing the taxes "is as much a question of machinery as anything else. Every new tax imposes a new burden upon the Board of Inland Revenue and the Office of Customs and Excise. They have a certain staff—an admirable staff, but necessarily limited in size —and we have to take care, unless our whole proposals for taxation are to prove a fiasco, that the duties thrown upon the Board of Inland Revenue and the Customs and Excise are duties they can perform in the course of the financial year."[211]

This anxiety lest taxes should be imposed which would prove too difficult to be well administered appears again and again in the debates. Thus in discussing possible new taxes in 1918 Mr. Bonar Law declared that "It has always been the pride of the British Government in regard to taxation that evasion should not be permitted"[212] and he rejected certain proposals because adequate administration could not be provided.

This recognition of the importance of the administrative work impressed the writer deeply in the course of his survey. It appeared to be one of the most striking points of contrast with the American situation. The Chancellor of the Exchequer, for ex-

210 Finance Act, 1917, sec. 26 (3).

211 Debates, 74: 345.

212 *Ibid.*, 105: 709.

ample, evidenced great pride in the skill and ability of the Inland Revenue. The same spirit was indirectly shown when others expressed the most complete scorn for those countries which permitted lax administration of their revenue laws.

Wide Discretion Vested in Administrative Authorities.—However, while the English realize the necessity of building up a civil service adequate to the administrative task involved in a new tax, once they feel they have a dependable corps of administrators they do not hesitate to vest them with great authority and responsibility. A mere reading of the statute is sufficient to show the striking extent to which they depend upon administrative discretion in assessing and collecting the Duty. Upon nearly a score of points the act grants the Commissioners of Inland Revenue discretionary power or power to give particular directions. The power is usually granted in broad terms. Thus, if in certain cases the commissioners are convinced that there should be changes in the Fourth Schedule which contains the rules for calculating profits, invested capital, statutory percentages, etc., they are given "power to allow such modification of any of the provisions of that schedule as they may think necessary in order to meet the particular case."[213] Among the powers granted them are these: rejection of frivolous and vexatious applications to the Board of Referees;[214] postponement of payment of Duty in cases under appeal;[215] determination of length of accounting period where accounts are irregularly made up or not made up;[216] permission to pay by instalments;[217] treatment of a company as a firm and directors as partners,[218] *etc., etc.*

Size of Administrative Problem.—The proportions of the administrative task cannot be guaged in this case by the mere number of assessments, nor can they be grasped by a numerical comparison between the two countries. Other elements are of great importance, such, for example, as the complexity of the laws administered and the portion of the administrative work which is shifted to the shoulders of the taxpayer himself.

So far as the comparative complexity of the laws is concerned,

213 Finance (No. 2) Act, 1915, sec. 40 (3).
214 *Ibid.*, sec. 42.
215 *Ibid.*, sec. 45 (6).
216 *Ibid.*, sec. 38 (2).
217 *Ibid.*, sec. 45 (1).
218 Finance Act, 1916, sec. 49 (1).

the advantage of simplicity lies with Great Britain, although the advantage is not so decisive as might be assumed at first glance. For, after all, the British Standard is an alternative one and the calculation of invested capital must be made in approximate fashion in almost every case. The administrators state that fully 80 per cent of the assessments are ultimately made on the basis of the profits standard, rather than the percentage standard, but even when the profits standard is used there are the modifications to be made because of variations in invested capital. However, the calculation of invested capital is decidedly less complicated under the British statute than under ours, while determination of profits is probably more so, due to the adjustments necessary to eliminate investment income and capital gains and to make the collection-at-source adjustments. The profits standard is, of course, more simple than the percentage standard and since with each passing year there is an increase in the percentage of concerns using the latter because of the initiation of new businesses and transfers in ownership of old ones, the British administrative problem constantly tends from this cause to become somewhat more complicated.

When one comes to consider the distribution of the labor of assessment between the administration and the taxpayer, the case is very plain. In Great Britain the Inland Revenue has assumed a much larger share of the burden than our Bureau of Internal Revenue. In England the imposition of the Duty imposed practically no additional burden of calculation at all upon the taxpayer. The local tax "surveyor" ordinarily already had on file information necessary to determine the liability of the concern. In cases of difficulty this surveyor supplied the taxpayer with skilled advice and assistance in the preparation of returns and ordinarily was able to arrive at an "agreement"[219] without requiring an appreciable amount of effort and time on the part of the taxpayer. The fact that the taxpayer can trust the surveyor to protect his interest as well as that of the government is a feature which impresses the American observer.[220]

About 50 per cent of British business concerns report on the basis of accounting periods which do not coincide with the calendar year. This results in a desirable distribution of the assessment work throughout the twelve months. On the other hand,

[219] *Cf. infra,* p. 107 *et seq.*

[220] *Cf. infra,* p. 103 *et seq.*

the British practice of establishing assessments for short accounting periods, sometimes as short as three months, tends to increase the work of the surveyor.

The figures of actual assessments made in the two countries are not satisfactory and complete. The Commissioners of Inland Revenue reported that in 1917 they made "about 60,000" and in 1918 "about 46,000" assessments of Excess Profits Duty and Munitions Levy.[221] Our Bureau of Internal Revenue has announced that in 1917, 232,079 corporations reported a net income but how many of these were subject to excess profits tax is not specified.[222]

Inland Revenue officials stated to the writer that the Excess Profits Duty had been administered without any expansion in the regular staff except for the addition of clerical assistance.[223] Moreover, in spite of heroic measures to hold men in this important public work, by 1917 more than 3000 men had left the Inland Revenue to join the fighting forces.[224]

Success of the Administration.—If general praise from everyone, including the taxpayers themselves, is any criterion of success in the administration, the assessment and collection of the British Duty has been very well done. The writer, after contact with officials of the Inland Revenue, with accountants whose practice brought them into close touch with the administration and with taxpayers, is filled with admiration for the efficient manner in which the machinery has operated and the general satisfaction it has given. Everyone agreed that the service had been promptly and fairly performed, that in spite of the complexities of the law, there had been almost no bungling, that outright evasion, at least during the war, had been practically non-existent and that the integrity as well as the intelligence of the administrative force had been beyond praise. In the course of his questioning on this point, the investigator heard only two criticisms. One manufacturer complained of what he thought was a tendency on the part of certain local surveyors to suggest original assessments which

221 Report 1917, p. 21; 1918, p. 21.

222 Statistics of Income compiled from the returns for 1917 under the direction of the Commissioner of Internal Revenue (Washington, 1919), p. 17.

223 *Cf.*, also, Cmd. 288-1, p. 6.

224 Debates, 93:379. Apparently this figure includes losses of other employees than the members of the technical staff. *Cf. infra,* p. 102.

were higher than they could hope to establish ultimately in the face of opposition from the taxpayer. He based his criticism primarily on one personal experience but he stated that he had heard of similar cases. One banker hinted at unevenness in the application of the provisions permitting special allowances, stating that a friend had boasted of having been able to get concessions in excess of a fair amount. This was the sum total of the criticism which the writer was able to extract. In other words there was practical unanimity of opinion regarding the complete success of the administration, from the serving of the original notices by the local surveyor to the disposition of the highest appeals by the Board of Referees.

Spirit of the Administration.—To a considerable extent, the satisfaction which the British feel with respect to the administration of their Duty is due to an immaterial element not included in the statutes, full as they are of special relief provisions and saving clauses. It is due to the spirit in which the administrator approaches his task. He meets the taxpayer with every disposition to be fair both to him and to the Treasury, and in cases of doubt as to what is fair, to be generous to the taxpayer. This attitude on the part of the local surveyors is deliberately fostered and encouraged by the higher officials of the Inland Revenue. The instructions issued to surveyors contain specific injunctions regarding the attitude to be assumed toward the taxpayer. There is full appreciation of the importance both of securing the taxpayer's coöperation and of getting assessments definitely settled in such a manner that they will not be constantly reopened for minor adjustments and corrections.[225] In the case of the Excess Profits Duty particularly, with its high rates and its many opportunities for disagreement, it has been considered wise to conduct the administration along broad lines. The assessors have not failed to utilize their administrative discretion. As one of them remarked: "We wipe off £20,000 one way or another as though it were a 'half-penny.'" The Board of Inland Revenue has specifically said to the local surveyors that "owing to the present high rates of taxation" they desired "that in doubtful cases the allowances granted in calculating Excess Profits Duty should err on the side of generosity rather than otherwise."

Again, in connection with the apportionment of the income

[225] *Cf. infra,* p. 103 *et seq.*

from long-term contracts,[226] the local surveyors are specifically ordered to apply the special procedure whenever it appears that it would result in an important alteration of the charge to the advantage either *of the taxpayer* or of the Revenue. The practical result of the spirit and the organization of our own administration is to put the initiative of claiming the benefits of such special procedure squarely upon the shoulders of the taxpayer alone, who would benefit from its adoption.[227]

There could scarcely be a greater contrast than that afforded by the attitude of the British administration and that of the ordinary local Collector of Internal Revenue in the United States, and much of the dissatisfaction with direct taxation which unquestionably exists in this country is traceable to the strict, petty, stickling over minor, inconsequential details. Long experience has taught the British the importance of vesting discretion in capable hands and insisting that that discretion be used fairly but in a generous spirit.

Assessment and Collection

With regard to both organization and procedure the study of the administration of the British Excess Profits Duty yields valuable suggestions for the improvement of the American system. In general the British administration is more extensive and comprehensive and at the same time much more decentralized than our own. The general plan of procedure is quite different, the Department of Inland Revenue assuming a much greater share of the administrative burden and leaving less to be carried by the taxpayer himself. Fortunately the British are able to utilize the excellent machinery built up through seventy-five years of income tax administration.

Machinery of Assessment and Collection.—However, while the administration of the Excess Profits Duty is interlocked with that of the income tax, it is distinctly different in several important particulars. There is not the complete merging of the assessment and collection of the two taxes which is found in this

[226] *Cf., supra,* pp. 40-41.

[227] Similar examples are numerous. The provision for the adjustment because of changes in invested capital is not strictly applied except in the interest of the taxpayer. Again, the Treasury does not withhold the benefits of Sec. 24 (4) of the Finance Act of 1918 from the taxpayer even though by a strict reading they could do so.

country. The general control of the administration of the Excess Profits Duty was given to the Commissioners of Inland Revenue, a body corresponding roughly to our Bureau of Internal Revenue. This body was already in charge of the income tax. In arranging the administrative plan for the income tax of 1842 these commissioners[228] had been vested with control of the tax from the point of view of safeguarding the interests of the Treasury. However, the powers of assessment and collection were withheld from the Commissioners of Inland Revenue and vested in unpaid, honorary, local boards. The Inland Revenue's power was primarily supervisory and regulative. The local boards, called the General Commissioners, appointed assessors and collectors annually. The Inland Revenue, to exercise its function of inspection, divided the country with "surveys" (which, by the way, did not coincide with the districts presided over by the General Commissioners) and recruited a force of surveyors. These surveyors appeared as representatives of the Treasury to check the work of the assessors, to make sure that the law in general was properly interpreted and administered. They were without formal power either to demand access to original accounts or to make an assessment but they were skilled, permanent, paid officials, engaged constantly in the application of a complicated statute, with a training in administration and with a knowledge of how problems were met in other parts of the country. In them the lore of procedure accumulated and upon them as the years went by the honorary General Commissioners and the annually-appointed assessors and collectors came to depend to a greater and greater extent. Even the "Additional Commissioners" appointed by the General Commissioners to determine assessments under Schedule D learned to defer to the judgment of the surveyors until their own function in the course of time degenerated in many districts to mere formal approval of settlements worked out by the surveyors. The situation as it exists today is aptly stated by Sir Thomas Collins, Chief Inspector of Taxes, in his testimony before the Royal Commission on the Income Tax[229] in 1919: "In practice, as is inevitable, it is the permanent whole-time official, the Surveyor of Taxes, whose whole working life is devoted to this highly technical subject matter, who shoulders the major part of the burden of examining returns and settling liabilities. It is

[228] Under a different name.

[229] Cmd. 288-1, p. 15 *et seq.*

he who comes into hourly contact with the taxpayer both orally and by correspondence, who checks the returns made, examines accounts, institutes inquiries, clears up doubtful points, and generally carries the work of ascertaining liability up to the point at which assessments are ready for allowance by the Commissioners. All notices of appeal against assessments are sent to him, he collects the information necessary to enable the points at issue to be determined, investigates the particulars received, and in all but a small fraction of the total number of cases comes to agreement[230] with the taxpayer without the Commissioners being troubled to do more than confirm the settlements which have been arrived at."

Although the elaborate machinery of local honorary boards with annually appointed assessors and collectors is generally recognized as obsolete and although everyone knows that the surveyors do practically all of the work,[231] strong opposition has always developed to any proposal for change. However, in mapping out a scheme of administration for the purposes of the new Excess Profits Duty, a clean break was made and the surveyor vested with the power corresponding to that which he had long exercised without formal authority. This was accomplished by giving the Board of Inland Revenue directly the power to require returns and make the assessments, which power the Board has delegated in large measure to its subordinates, the surveyors. Thus it comes about that the General Income Tax Commissioners have nothing to do with the Excess Profits Duty except in connection with certain types of appeals.[232] Assessments are determined and collection notices are served in ordinary cases by the surveyors.

Board of Inland Revenue.—As has been noted, the Commissioners of Inland Revenue, also referred to informally as the "Board of Inland Revenue," are charged by the statute with full responsi-

230 *Cf. infra,* p. 115 *et seq.*

231 Evidence submitted to the Royal Commission on the Income Tax showed that in 22 divisions the number of adjustments made by the surveyors and accepted by the Commissioners was 66,533, the number of appeals heard personally by the Commissioners was 1,263 and the number of taxpayers who appeared personally before the Commissioners to prove formally their title to sums previously agreed upon with the Surveyor was 223. Cmd. 288-1, Appendix 4, p. 31.

232 *Cf. infra,* p. 119 *et seq.*

bility for the "care and management"[233] of certain specified sources of revenue among which are included the Income Tax and the Excess Profits Duty. This board, like our Bureau of Internal Revenue, forms a part of the Treasury and is accountable technically to the Lords of the Treasury but actually to the Chancellor of the Exchequer. From its quarters in Somerset House it supervises the assessment and collection of its revenues, transfers its collections to the Exchequer and performs such other duties as the Chancellor may assign to it, such, for example, as the formulation of revenue proposals and the preparation of legislation.

The Board of Inland Revenue has an organization for the accomplishment of its functions which consists in the main of a permanent secretary, a number of assistant secretaries, a staff of inspectors, and a force of surveyors and assistant surveyors. In the administration of the Excess Profits Duty the "exception principle" of management has been fully utilized, the general rules of procedure being formulated and communicated to the rank and file of the surveyors, who were then expected to operate on their own initiative as far as possible, settling all except the most difficult and important cases without calling upon their superiors. The work is thus decentralized, the details kept in the offices of the surveyors, and the time and effort of the higher officials conserved for the consideration of special problems. The general tendency, moreover, is distinctly in the direction of greater and greater decentralization.

The formulation of the official interpretation of the Duty and the preparation of the instructions to the surveyors were entrusted to a small informal committee of high officials in the Inland Revenue which was formed shortly after the passage of the Act. Later the special problems which arose in the course of the administration were placed before this committee for consideration. It was a body too informal to have a definite name or title. It consisted of four men, three being Secretaries to the Board and one a member of the staff of inspectors. It performed approximately the same duties as the groups of economists and business men

[233] The Minutes of Evidence of the Royal Commission on the Income Tax which was sitting in the summer of 1919 contain full particulars regarding the English administrative system. The evidence is printed in seven large volumes (Cmd. 288-1 to 288-7) together with an index (Cmd. 288-8) and an abstract (No number). The report itself is published separately (Cmd. 615).

known as the Excess Profits Tax Advisors and Reviewers performed for our Treasury. It should be especially noted that this body was entirely separate from the Board of Referees specifically established in the act to care for certain appeals and cases of unusual hardship, with which our "advisors" and "reviewers" are very often compared.

The Technical Staff of the Board of Inland Revenue.—The "technical staff" of the Board of Inland Revenue consists of the inspectors, the surveyors and the assistant surveyors. The total authorized number of the staff is 1225, but in the summer of 1919 there were some 80 unfilled positions.[234] There are 601 surveyors' districts each in charge of a surveyor, who often has the aid of assistant surveyors.

The remuneration paid the members of the technical staff is not large but there must be taken into account the various indirect emoluments which accrue to the English civil servant. In addition to security of tenure and liberal pension provisions, the positions carry with them a marked degree of social prestige. Brilliant and meritorious service is sometimes rewarded by a decoration and even by a knighthood. The salary scale as it stood in the summer of 1919 was as follows—the figures being subject to additions through special war bonus:

Number of Officials		Range of Salary £
120	.....	150 to 250
600	.....	250 to 500
320	.....	550 to 700
160	.....	750 to 900
22	.....	925 to 1000
2	.....	1100
1	.....	1200
1225		

The technical staff is ordinarily recruited by competitive examinations and the positions are sought in many cases by well-trained university men. New members to the staff are ordinarily first made assistant surveyors and placed under the direction of an experienced man. After a period of training they are put in charge of a district and thrown upon their own responsibility. As a matter of policy, men are usually assigned to strange districts and are given important work to do while still very young.[235]

[234] Cmd. 288-1, p. 15.

[235] Sir Thomas Collins testified that he was placed in charge of a district before he had reached the age of 23. *Ibid.*, p. 21.

Special merit is recognized by quick promotion. In general, advancement in the service is said to depend upon seniority only to a minor extent and factors such as attention and regularity in their duties, industry and faithfulness are given great weight. An ability on the part of the surveyor to meet his own problems and to settle cases by agreement without constantly leaning on his superiors is highly valued.[236] The danger of encouraging surveyors to make settlements at too great a cost to the Revenue is avoided by careful inspection and by the transfer of surveyors from district to district.

It has been pointed out that during the two years 1917 and 1918 the total number of Excess Profits Duty assessments made was about 106,000.[237] This would average about 175 for each surveyor, or 87 per year. If it be assumed that 150,000 American corporations out of the 232,079 which report a taxable income are subject to excess profits tax, it would appear that to provide this country with the same assessment equipment would involve the establishment of some 1700 districts in place of the present 64 collection districts—or about 35 to each state.

It must not be thought, however, that the local assessors give complete satisfaction and make entirely superfluous the use of private lawyers and accountants in the preparation of tax returns. It is true that they do much of the work which in this country is performed by the taxpayer or his "tax expert," but they are, of course, busy men and can give only a moderate amount of time to advising each taxpayer regarding the preparation of his assessment data. Some complaint has been made of the inadequacy of the force of surveyors, large as it is as compared with our own.

Relations between Surveyors and Taxpayers.—The relationship between the English taxpayer and the local tax official is strikingly different from that which exists in the case of the American taxpayer. Here the chief functions of the local official are the mechanical ones of distributing forms and accepting checks. Advice he gives when it is requested but, where the issue is material, wise taxpayers place little dependence upon his counsel. The general principle of our procedure is that of self-assessment, checked by a subsequent audit. The British prin-

[236] Cmd. 288-1, p. 21 *et seq.*

[237] *Cf. supra,* p. 94 *et seq.*

ciple is that of a definite original assessment by the surveyor after consultation and agreement on disputed points.

Self-assessment, such as we attempt, is possible only if the taxpayer is fully informed regarding the law and its interpretation and consequently the Bureau of Internal Revenue publishes broadcast appallingly large quantities of explanatory matter—regulations, treasury decisions, rulings, letters of instructions, notes and memoranda. The tax returns, when filed, are supposed to conform to the interpretation laid down in these documents. In other words, each taxpayer is supposed to qualify as an expert in procedure and to assess himself in accordance with departmental interpretation. If he departs from this interpretation he will be subject to correction, and, perhaps, to penalty if the irregularity is noticed when the return is audited. If he disagrees with this interpretation he may go to the courts for his remedy. Much of the dissatisfaction with the present federal income and profits taxes arises from irritation caused by the burden of preparing assessments under these conditions.

In sharp contrast with the arrangement just described the English place the assessment burden squarely on the local tax official—the surveyor. The taxpayer is asked to submit a return to him setting forth certain facts from his books and may be requested to furnish him with copies of his original Trading Accounts, his Balance Sheet and his Profit and Loss Accounts. In due time the assessor informs him of his tax liability, having checked over the figures in the meantime and conferred with him to any extent necessary. The taxpayer, however, is relieved of the necessity of taking the initiative in applying an interpretation of the law to his own particular case.

It is frankly recognized that assessments of the type made under an excess profits or income tax cannot be arrived at with absolute accuracy because of the valuations involved which rest fundamentally upon individual judgment and opinion. Consequently the opportunity is provided for discussion and compromise on the many points concerning which there may be differences of opinion, particularly those involving valuations. The limitations within which the surveyor may exercise his discretion are carefully defined and only the important irregularities are passed up to the inspectors or to Somerset House. Even then the decisions of these higher officials are made effective through the local surveyor. He also issues the notices, even those

relating to collections. Full provision is made for administrative appeals,[238] where decisions are arrived at in the spirit of arbitration.

As a result of this different distribution of assessment functions in which the surveyor is given a high degree of authority and responsibility a situation arises in which it is neither necessary nor desirable that the taxpayer be required to become fully informed as to treasury interpretation and departmental procedure. Consequently the Board of Inland Revenue issues no flood of interpretative material which it asks the taxpayer to digest and accept as a rule of action. He has the statute and almost nothing more—for the eight-page leaflet[239] given him with his form contains little else than a digest of the statute. In this leaflet he is told that "information relating to any of these subjects can be obtained from the Surveyor of Taxes by persons concerned." This official will explain to him how the law has been applied to his particular case and is willing to discuss the reasonableness of the interpretation. If dissatisfied with the final position of the surveyor the taxpayer may appeal.[240]

Assessment Procedure.—The statute declares[241] that "The Excess Profits Duty shall be assessed by the Commissioners of Inland Revenue, and shall be payable at any time, not being less than two months, after it is assessed." There is also the following specific statutory authority to require returns: "The Commissioners of Inland Revenue may, for the purposes of this Part of this Act, require any person engaged in any trade or business to which this Part of this Act applies, or who was so engaged during any accounting period or pre-war trade year, to furnish them within two months after the requirement for the return is made, with returns of the profits of the trade or business during the accounting period or pre-war trade years and such other particulars in connection with the trade or business as the Commissioners may require."[242]

As has been seen[243] the Board of Inland Revenue has delegated

238 *Cf. infra,* p. 115 *et seq.*
239 Form No. 1 A—E. P.
240 *Cf. infra,* p. 116 *et seq.*
241 Finance (No. 2) Act, 1915, sec. 45 (1).
242 *Ibid.,* sec. 44 (1). *Cf.,* also Finance Act, 1916, sec. 47 (c).
243 *Cf. supra,* p. 99 *et seq.*

to the Surveyors power to exercise their functions of assessment in all but the cases of exceptional difficulty.

Person Assessed.—The person subject to assessement is the one "owning or carrying on" the business "for the time," or his agent.[244] Where there has been a change of ownership the Commissioners have power to assess the former owner for the duty up to the date of sale. This enables the Commissioners to reach the former owner in a case where he has made large profits but where the purchaser has lost.

The Initiation of the Assessment.—Unlike the British income tax which is assessed at one date with respect of accounting periods ending within the preceding twelve months, but like our own income and excess profits tax, the Excess Profits Duty is assessed shortly after the close of the accounting periods, whenever they chance to occur. The onus of initiating the assessment legally lies, as with us, upon the person subject to the tax. The original act, passed December 23, 1915, provided that every person chargeable to the Duty should give notice to the Inland Revenue before January 31 following.[245] Subsequent amendments made the limit for giving notice two months.[246]

The surveyor not only has these notices of liability as a basis for his list of taxable concerns, but he has in addition the income tax data which have been submitted in his district, all properly filed away and available for purposes such as this, as well as certain confidential material dealing with war contracts with the government. Acting upon these notices of liability and this additional information, the surveyors make the technical "requirement for the return"[247] by sending return forms to the concerns by registered mail. If no response is received within two months a reminder is mailed. In cases of continued delay or in cases where for any reason a definite assessment cannot be arrived at the Surveyor in order to prevent the improper inflation of invested capital for the succeeding period because of unassessed duty, makes an arbitrary assessment not later than ten months after the close of the accounting period.

244 Finance (No. 2) Act, 1915, sec. 45 (2). No liability attaches to the purchase of trading stock for Duty levied on the profits of the sale by sec. 35 of the Finance Act of 1918.

245 *Ibid.*, sec. 44 (2).

246 Finance Act, 1916, sec. 45 (3); *ibid.*, 1917, sec. 20 (3).

247 *Cf. supra*, p. 100.

The Determination of the Assessment.—Upon receiving the return form, properly filled out, the surveyor proceeds to examine it, to confer with the concern upon any doubtful points and to calculate the assessment. In the course of this process he makes every endeavor to arrive at some mutually satisfactory solution of problems which may arise between the taxpayer and himself. However, if he finds it impossible to agree[248] with the taxpayer, he proceeds to fix the assessment at the figure which he believes to be equitable. The taxpayer may give the surveyor notice of appeal within 30 days after the assessment has finally been served upon him. Before mailing the formal notice of assessment, the assessor includes the item in a list which he sends to the Commissioners of Inland Revenue for their formal approval. Upon receiving assurance that his list has received the sanction of the board the notices of assessment are mailed. Payment is due within two months after service of the notice.

Additional assessments may be made by the Commissioners of Inland Revenue at any time within three years after the date of the original assessment, but they may make no additional assessment in any case where the amount of the original assessment has been reduced on appeal to the General or Special Commissioners or by any court by which an appeal has been reheard.

Agreements with Taxpayers.—Agreements in the nature of a compromise, assented to by both taxpayer and governmental representative, do not form a prominent part of American procedure. The Treasury conceives it to be its function to make a strict interpretation of the law, resolving questionable points in favor of the government. Consequently a reasonable interpretation of a statute is ordinarily arrived at only after taxpayers have carried the narrow Treasury interpretations to the courts, which in the past have shown a general disposition to decide doubtful points in favor of, rather than against the taxpayer. This attitude on the part of the Treasury has tended to generate a spirit of animosity and bitterness in the taxpayers, already often irritated by the labor involved in preparing returns and the difficulties involved in securing decisions on moot points.

In England the general situation is different. There the Inland Revenue has learned long ago that nothing is more necessary in a tax of this type than a spirit of liberality in its administra-

[248] *Cf.* following section.

tion.[249] Instead of construing every possible point in favor of the government, the case for the taxpayer is given at least equal consideration. In cases of difference of opinion as to valuations the administration is quick to make concessions on the basis of evidence submitted by the taxpayer. The ordinary surveyor is impressed with the notion that it is his business to settle questions rather than merely to pass them on mechanically to some other bureau official who may be in a less favorable position than himself to make a wise decision. Consequently the surveyor is encouraged[250] and supported in a policy of arriving at "agreements" with taxpayers. These agreements virtually carry the force of a bargain entered into by two responsible parties and in the absence of fraud or deceit they are not disturbed. The taxpayer gets certainty and quick decisions. The government keeps up to date with its work and gets its money promptly,—probably more money than otherwise. British officials express amazement at our cumbersome methods of administering a tax of the type of the Excess Profits Tax.[251]

Simplicity of Forms.—The forms used in the administration of the British Excess Profits Duty are refreshingly simple and free from troublesome complications. This desirable result is obtained chiefly as a corollary of the administrative proposition that the tax official and not the taxpayer shall administer the law. The surveyor asks for certain specific figures, supported in some cases by copies of certain accounts. He then makes the adjustments, establishes the taxable profit and determines the Duty. The detailed explanatory material is confined to a small separate

[249] *Cf. supra,* p. 97.

[250] *Cf. supra,* p. 103.

[251] The manner in which important adjustments are left to the surveyors and the general attitude of the administration toward the taxpayer are illustrated by the following occurrence. A deputation from the Association of Chambers of Commerce to the Chancellor of the Exchequer raised the question as to the reserves which might be accumulated against probable losses on contracts entered into before the war or early in the war. The following colloquy ensued:

"The Chancellor of the Exchequer: But I understand the principle on which we go is that you are allowed to hold back in suspense a sufficient amount of what would be the Excess Profits Duty to cover what apparently is the loss on pre-war contracts.

"Mr. George Wigley: Are we allowed to do that?

"Mr. G. W. Currie: The surveyors are willing to discuss the matter." Cham. of Com., 1918, p. 16.

leaflet which can be enclosed with the return form. Care is observed not to ask the taxpayer for any unnecessary data.

The complaint so often heard concerning the complexity of our forms in this country probably cannot be eliminated until an administrative organization can be built up which will permit a distribution of the work of assessment similar to that found in Great Britain.

Secrecy.—Under a theory of procedure such as that outlined above, in which the surveyor is put into direct touch with the taxpayer and given definite authority to arrive at an assessment, there are certain advantages in a policy of secrecy with regard to interpretation and practice. The view taken by the British is that the taxpayer should conduct his business and keep his accounts as though there was no such thing in existence as an income or profits tax. Detailed knowledge as to exactly how the Inland Revenue will apply the tax may lead, they feel, to "rigging" the accounts and resorting to various devices for evasion. Consequently in place of the fullest publicity of rulings, precedents and instructions, there is a policy of secrecy. The surveyor is furnished with an elaborate book of instructions, which in the case of the Excess Profits Duty consisted of three hundred printed pages, containing a complete manual of procedure. But this book is for official use only and is strictly confidential. Even the forms are for the most part considered confidential. Whatever may be said as to the general merits of this policy, it does have a tendency to add to the strength of the position of the surveyor when he enters into a conference with the taxpayer in order to determine the extent of his liability.

In addition to being in a position to expound the procedure to the taxpayer the surveyor often possesses an advantage because of information confidentially furnished him by other governmental departments regarding the business of the taxpayer. For example, particulars relating to contracts made during the war by the War Office, Admiralty and Minister of Munitions were forwarded to surveyors and were used by them as a basis for specific inquiries as to liability to tax. Used with discrimination, such material has great possibilities as a check on the accuracy of accounts, especially since the taxpayer never knows the precise extent of the knowledge of the surveyor.

The influence of the policy of secret instructions and confidential information is of considerable importance. Of course

without capable local officers such a policy would be ridiculous. However, assuming this point to be covered, the policy undoubtedly contributes materially toward accomplishing the desired end of a definite assessment, determined promptly and with some degree of finality, at a figure at once approximately just to the taxpayer and fair to the government. In this country conferences between taxpayers and representatives of the Bureau of Internal Revenue often show the advantage to be all on the side of the taxpayer. To start with, the taxpayer's representative is often a more capable person than the official and in addition he often knows more about the Treasury's own interpretations than the official himself. Consequently the official often approaches a conference with a consciousness of disadvantage which breeds a desire to avoid issues rather than to settle them. This desire is furthered by a conviction that, while blunders are apt to be punished, meritorious service will almost certainly go unrewarded. The final result is that difficult questions are pigeonholed and are often allowed to go by default because of the reluctance to assume responsibility.

The contrast with the English procedure could scarcely be greater. There the surveyor is armed with secret information, supported by an organization of superiors and ordered to arrive at agreements with the taxpayers. His official standing is injured if he pigeonholes cases or avoids issues. The result is definiteness in assessment—a quality sadly lacking in the American situation.

Prevention of Evasion.—The statute states that a person shall not "for the purpose of avoiding the payment of any Excess Profits Duty, enter into any fictitious or artificial transaction or carry out any fictitious or artificial operation."[252] This section is designed to cover such cases as alterations in the method of stocktaking, manipulations of stock, inner reserves, payment of unreasonable salaries to relatives, etc. If any such transaction occurred before the commencement of the Act, the taxpayer is directed to inform the Commissioners regarding it. Failure to comply with this provision carries a penalty of a fine not exceeding £100.

Penalties.—Failure to give the required notices or to make the

[252] Finance (No. 2) Act, 1915, sec. 44 (2).

required returns subjects the offender to a fine of not more than £100 plus £10 for each day's delay after conviction.[253]

Collection Procedure.—Since the line between avoidance and evasion is so difficult to draw and since the efforts to avoid the tax are the cause of many of the serious economic consequences of the Duty, the whole treatment of evasion is relegated to Part Three.[254] This section, consequently, is devoted to the mere mechanics of collection.

As has been seen, the notice of assessment mailed by the surveyor serves as a notice to pay. Remittances must be made to Somerset House[255] within two months of the date of service of the notice. The surveyor notifies the Accountant General of the notices issued by him so that he is informed as to the total levies. The surveyor receives a notification of all payments made, files all the correspondence and keeps a record of the exact status of each taxpayer's account.

Payment Pending Appeal.—The ordinary rule is that payments must be made notwithstanding any appeal but the Commissioners of Inland Revenue may make exceptions.[256] In practice the surveyor is urged to make collections on the basis of agreed tentative assessments which will at least cover the part of the liability not under dispute.

Of particular interest to Americans is the injunction included in the statute that "the Commissioners shall make such repayments, if any, as are necessary to give effect to any decision on appeal, *as soon as possible after such decision has been given.*[257] Under our system a taxpayer cannot test the merits of his contentions in court without first having paid the tax and then suing to "recover back" the amount so paid. So long as the taxes were moderate in amount this rule perhaps worked no considerable hardship, but at present the payment of a wrongful assessment may work extreme hardship pending the final determination of the taxpayer's appeal.

Payments in War Bonds.—The Finance Act of 1917 contained

253 Finance (No. 2) Act, 1915, sec. 44 (2).

254 *Cf. infra,* p. 147 *et seq.*

255 In the case of England and Wales. Separate collection depots are provided for Scotland and Ireland.

256 *Ibid.,* sec. 45 (6).

257 Italics are the writer's. *Ibid.*

a section making war bonds acceptable in payment of Excess Profits Duty. The law stated that, under Treasury regulations, "any stock or bonds forming part of any issue made for raising money in connection with the present war" would be accepted at a valuation determined by "the price of issue with the addition of any interest accrued."[258] An amendment the following year[259] qualified the phrase "price of issue" by the addition of these words: "or such other price as was specified in the conditions subject to which the stock or bonds were issued as the price at which the stock or bonds were to be valued for the purposes of this section." The price specified for this purpose is the nominal value, *viz.*, discounts or premiums included in the price of issue are eliminated.[260]

Prepayments.—Statutory provision is made permitting the deposit of sums with the commissioners for the purpose of satisfying Excess Profits Duty not yet payable. Interest on such deposits is allowed "at such a rate as may for the time being be determined by the Treasury."[261] The rate before March 3, 1917, was 5½ per cent. Since that date it has been 5 per cent.

The fact that these prepayments are made complicates the figures of levies and collections. In 1917 the Commissions of Inland Revenue included the following statement in their report: "Many traders availed themselves of this privilege and in consequence the Exchequer receipt within the year was considerably swollen, the total amount remaining on deposit on 31st March being £14,800,000."[262]

Surveyors take the opportunity, especially in cases of magnitude, to call the taxpayer's attention to the advantage of depositing amounts in advance, and, unless a deposit was made, the Surveyor will not ordinarily agree to extensions of time for making returns in the case of taxpayers having funds readily available for payment of the tax. Where, after an assessment had been made, a balance of any such deposit remained on hand, that balance will, at the option of the taxpayer, either be refunded to him

258 Finance Act, 1917, sec. 34.

259 *Ibid.*, 1918, sec. 42.

260 It appears that some restriction is contemplated in the acceptance of bonds in payment of the Duty. London *Times*, July 3, 1920.

261 Finance Act, 1916, sec. 54.

262 Sixtieth Report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1917 (Cmd. 8887), p. 21.

without interest, or retained on deposit with a view to satisfying a future liability. This British practice is the reverse of the practice followed in this country. Here the taxpayer, by claim for abatement, stays the collection of the tax until questions affecting the assessment have been settled, at which time he pays the amount of the additional assessment with interest at the rate of 6 per cent (prior to 1918 at the rate of 12 per cent) on that amount of the claim for abatement which is finally disallowed.

Interest on sums deposited in prepayment of the tax is included in taxable income for purposes of income tax but is ordinarily excluded from profits subject to the Duty. However, if the taxpayer prefers, he may include the interest in his profits and then use the amount of the deposit as invested capital.

In addition to the interest allowance on sums deposited in advance of assessment, a discount is given when a concern pays the Duty after the assessment but more than a week before the payment is due.

Payment by Instalments.—The statutory rule is that the Duty is "payable at any time, not less than two months, after it is assessed," but the "Commissioners may, in any case where they think fit, allow the Duty to be paid in instalments of such amount payable at such times as the Commissioners direct."[263]

In this country the Excess Profits Tax originally assessed may be paid in four quarterly instalments. Postponements are often secured in the case of additional assessments made on the basis of subsequent audits, by the somewhat irregular device of persuading the Treasury officials to postpone the technical service of "notice and demand."

In England the Commissioners of Inland Revenue have laid down no specific rules of general application to govern the payment of the Duty by instalments. The general rule is that the entire amount shall be paid within the two-month period but when extensions are requested the Board has been liberal in granting them. Within broad limits discretion is vested in the local surveyor to determine the conditions of payment. Since no interest is charged the taxpayer because of the postponed instalments there is a distinct advantage securing the privilege. An official of the Inland Revenue estimated that perhaps ten per cent of the

[263] Finance (No. 2) Act, 1915, sec. 45 (1).

concerns are given extensions, that ten per cent including many of the large taxpayers.

The extensions permitted are usually short. The period ordinarily ends within six months after the tax was originally due and the Duty is usually divided into two or three equal instalments. In certain cases of particular hardship the payments were distributed over a period ending not later than 9 months after the tax was originally due or 18 months after the close of the accounting period for which the Duty was assessed.

The British have experienced the difficulty encountered in this country arising from the fact that the assessment is often made against profits represented by inflated inventories or invested in new plant or extensions. Acting on the basis of a definitely announced government policy the Inland Revenue has been liberal in granting extensions where such conditions obtained. This liberality has prevented acute distress but has resulted in the accumulation of very considerable arrears. In this country assessed federal taxes are promptly collected but it is impossible to say how large is the amount of taxes really due the Treasury which will not be assessed until uncovered in the course of the Departmental audits.

Inland Revenue officials admit that the discretionary power to postpone payments vested in them has resulted in some degree of embarrassment to them. At times, the writer has been told, they are imposed upon. Thus one manufacturer confessed that he had secured from a friendly banker a note refusing to lend him money to pay his Duty, which note he used to secure a tax extension when, as a matter of fact, it would not have been difficult for him to have raised the money. Such cases, however, are doubtless rare. Borrowing from the banks has been resorted to in a few instances but the bankers testify that this is an unusual occurrence. There have been no business failures directly traceable to the Duty but, of course, there have been various undesirable results such as restricted developments and depleted reserves. The sentiment of the business men has, naturally enough, been in favor of greater liberality in the extensions rather than a more strict policy of collections.[264]

[264] *Cf.* Deputation from the Association of Chambers of Commerce of the United Kingdom to the Chancellor of the Exchequer. June 15, 1917, p. 61 *et. seq.*

Arrears.—When so large a proportion of the outstanding levy is covered by the elastic power of the Inland Revenue to grant extensions, it is not proper, strictly speaking, to refer to the amounts remaining uncollected as arrears. Moreover, the policy of encouraging prepayments complicates the figures and makes exact statements difficult. However, the Board of Inland Revenue reported that at the end of the year 1916-17 there remained unpaid Excess Profits Duty to a total amount of about £35,000,000.[265] A year later this figure had grown to about £96,883,910.[266] In the summer of 1919 the writer was told that the total arrears were approximately £200,000,000, roughly one-fourth the amount of the aggregate cash collections from the Duty. In this country this would seem an alarmingly large sum. If we are less prompt in determining final assessment we certainly appear to be more prompt in making our collections.

Appeals

Much more elaborate and well-defined machinery for the consideration of appeals is provided under the British system than under the American. On this point we are woefully weak with our overcentralized administration and our complete lack of administrative appeal to other bodies than those themselves responsible for the appealed assessments. Recourse to the courts may be made more freely here than there but this is such a slow and costly remedy that it frightens many taxpayers. They usually prefer to endure the grievance but they endure it with grumbling and dissatisfaction which adds to the general discontent with the tax.

In England appeals for administrative modification or relief may be made to one of three authorities, depending upon the nature of the appeal.

(1) Since the Commissioners of Inland Revenue are themselves the legal assessors it is not proper, strictly speaking, to refer to them as an appeal body. However, they are given wide discretion in the statute to make modifications in the calculation of the Duty either upon their own initiative or upon specific application from the taxpayer. On certain points the final appeal is to this body.

(2) In the cases of certain specified topics, taxpayers dissatis-

[265] Report, 1916-17, p. 21.

[266] *Ibid.*, 1917-18, p. 21.

fied with the decisions of the Commissioners of Inland Revenue may appeal from them to the Board of Referees, established under the law. This Board of Referees, moreover, has original authority to determine the reasonableness of applications for increases in the statutory percentage and certain similar matters.

(3) In case of dissatisfaction with the *amount* of the assessment there is a general right of appeal to the regularly constituted appeal authorities under the income tax, *viz.*, the General Commissioners or the Special Commissioners, but the matters specifically delegated to the discretion of the Commissioners of Inland Revenue and the Board of Referees are not subject to this appeal.

In addition a case may be stated on a point of law for the opinion of the High Court.[267] Such cases are not frequent. Thus far not a single appeal has been made from the decisions of the Board of Referees. The ordinary grivances, the appeals for special treatment and the complaints against the action of the assessors are cared for by the machinery described above. On almost every question of fact concerning which the taxpayer may disagree with the surveyor he may appeal to a body entirely independent of the Treasury which functions in accordance with the principles and spirit of arbitration. The system has given general satisfaction in operation.[268]

Appeals to the Commissioners of Inland Revenue.—The Commissioners of Inland Revenue assess the Excess Profits Duty[269] but, as has been seen, the detailed work of arriving at the liability of the taxpayer is delegated in large measure to the surveyors in the local districts. Thus it comes about that the higher officials of the Inland Revenue, the inspectors and the secretaries, perform a general function of review and appeal in the course of the action of formally establishing the assessments. There are a

[267] Cmd. 288-1, p. 18.

[268] A complaint made by the deputation from the Association of Chambers of Commerce of the United Kingdom, at the Treasury, 24th April, 1917 (p. 13), is based in part at least on a misconception. This deputation preferred the appeal system used under the Income Tax but apparently did not understand that the line of demarkation between the powers of the Inland Revenue and those of the general commissioners is not strictly drawn in practice and did not realize that the Board has no option but to refer to the Referees appeals under Section 40 (3).

[269] *Cf. supra*, p. 99.

large number of points upon which the Commissioners of Inland Revenue are given power either to exercise discretion or to give specific directions. Certain of their decisions are subject to appeal to the Board of Referees. Certain others may be appealed to the income tax authorities—the General Commissioners or the Special Commissioners. Certain other points are decided finally by the Inland Revenue.

Some points are taken up for review or special consideration on the initiative of the taxpayer. Others are given special treatment by the Commissioners of Inland Revenue without special action by the taxpayer.

In addition to its other functions the Inland Revenue receives and transmits certain appeals to the Board of Referees, on which the Commissioners have no power to take action except that they may eliminate any which they consider "frivolous or vexatious" or duplications of cases already decided.

The points upon which there is no appeal from the decision of the Commissioners of Inland Revenue include such matters as the determination of the limits of an accounting period, the determination of the allowance for directors' remuneration,[270] the apportionment of the profits of long-term contracts, and the evaluation of good will for purposes of invested capital in cases of reorganizations—mostly technical points where uniformity of treatment is important.

An appeal is given from the decision of the Commissioners to the Board of Referees in cases in which they have exercised their broad powers to modify the provisions grouped under the "Fourth Schedule"[271] which includes the rules governing the determination of profits, the establishment of the pre-war standard and the computation of invested capital. The language of the law is as follows:[272]

"Where it appears to the Commissioners of Inland Revenue on the application of a taxpayer in any particular case, that any provisions of the Fourth Schedule to this Act should be modified in his case, owing to a change in the constitution of a partnership, or to the postponement or suspension, as a consequence of the present war, of renewals or repairs, or to exceptional depreciation or obsolescence of assets employed in the trade or

[270] *Cf. supra,* pp. 43-44.

[271] *Cf. infra,* Appendix A, II.

[272] Finance (No. 2) Act, 1915, sec. 40 (3).

business due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war, or to any other special circumstances specified in the regulations made by the Treasury, those Commissioners shall have power to allow such modifications of any of the provisions of that Schedule as they think necessary in order to meet the particular case."

The commissioners are granted no powers of discretion in transmitting to the Board of Referees appeals under this section from taxpayers dissatisfied with the modifications allowed by them.[273]

The authority granted to the Inland Revenue in the section quoted above is much broader than the similar authority granted in our statute[274] to the Commissioner of Internal Revenue. The British statute allows such adjustment as the Commissioners of Inland Revenue may "think necessary in order to meet the particular case." Our statute permits the Commissioner to make the assessment on the showing of representative corporations engaged in a like or similar trade or business. In this country the Commissioner of Internal Revenue must accomplish by indirection what the British statute permits the Commissioners of Inland Revenue to accomplish directly. Under our statute, no matter how clearly the abnormal conditions affecting a particular taxpayer may be adjusted for the purpose of assessing the excess profits tax, the Commissioner is not authorized to make such adjustment. His authority extends only to waiving assessment under the specific rules of the statute and to making an assessement based upon the amount of tax paid by other taxpayers engaged in a like or similar trade or business. It is well known that in the same general trade or business particular concerns may be found which pay very large or very small amounts of tax and the specific corporations which may be chosen by the Commissioner for the purpose of comparison was, under the 1917 statute, at least, ap-

[273] Finance (No. 2) Act, 1915, sec. 40 (3). The Finance Act of 1916 (sec. 47, d) excluded a purchaser of a ship from obtaining, under this section, "any greater relief than could have been obtained by the vendor if the ship had not been sold, other than relief in connection with expenditure by the purchaser on improvements or repairs."

In the case of a controlled estalishment "a referee or board of referees appointed or designated by the Minister of Munitions" might be substituted for the Excess Profits Duty Board of Referees. Finance Act, 1916, sec. 55.

[274] Revenue Act of 1917, sec. 210; Revenue Act of 1918, sec. 328.

parently governed only by his determination to reach an amount of tax which in his opinion was proper to assess in the case under review. In other words, he was able, as a matter of fact, to accomplish indirectly that which he was not authorized to do by the statute, namely to take into consideration the particular abnormal features of a case and determine an amount of tax which in his opinion was just and equitable.

It will be noted that "exceptional depreciation" is included among the conditions which would justify a British taxpayer in applying to the Commissioners of Inland Revenue for a modification of his assessment, and, if dissatisfied, in carrying his appeal to the Board of Referees. In addition to this provision an amendment was passed in 1918[275] which required the Commissioners of Inland Revenue to transmit to the Board of Referees applications "for the alteration of the amount of any income tax deduction for wear and tear"—merely ordinary depreciation—unless they considered such applications "frivolous or vexatious."

This same discretionary power to weed out appeals is given to the Commissioners of Inland Revenue in cases of application to the Board of Referees for changes in the standard of profits under Section 42 of the statute.[276] The Commissioners may decline to refer the application to the board "if they are of the opinion that the application is frivolous or vexatious or refers to matters already decided by a Board of Referees."

The cases upon which action by the Commissioners of Inland Revenue is subject to review by the regular income-tax appeal authorities consist of those relating to the *amount* of the assessment which do not have a special right of appeal under the act.[277]

Appeals to Income Tax Commissioners.—It will be noted that the appeals on questions which are peculiarly Excess Profits Duty problems are ordinarily referred to the Board of Referees, either after action by the Commissioners of Inland Revenue or without such action. Other questions go to the regular appeal authorities established for income tax purposes. The statute provided that

"Any person who is dissatisfied with the amount of any assessment made upon him by the Commissioners of Inland Revenue . . . may (except in cases where a special right of appeal is given . . .) appeal to the General Commissioners or the division

[275] Finance Act, 1918, sec. 24 (1).

[276] *Cf. infra,* p. 125.

[277] *Cf.* following section.

in which he is assessed, or to the Special Commissioners. . . .[278]

It should be noted particularly that it is the *amount* of the assessment which is subject to appeal. Several points which affect the amount only indirectly, such for example as the limitation of the accounting periods, and several points specifically left to the discretion of the Board of Inland Revenue may not be so appealed.[279]

The General Commissioners referred to are members of local honorary, unpaid boards which are technically in charge of the income tax assessments. Their full title is "Commissioners for the General Purposes of the Income Tax." They are often referred to colloquially as "Local Commissioners" or "District Commissioners." In 1919 there were approximately 5,600 of these General Commissioners in Great Britain. They are appointed upon the nomination of the Land Tax Commissioners from among their own numbers. All Justices of the Peace are *ex officio* Land Tax Commissioners and others are appointed from an eligible list made up of those who have been included in a "Names Act" which is passed by Parliament from time to time. How the "Names Acts" are compiled appears to be one of the unsolved mysteries of British governmental organization.[280]

The Special Commissioners, who are also designated as appeal authorities coördinate in power with the General Commissioners, are income tax officials of long standing. They owe their origin to a desire on the part of business men to be given the right of appeal, in income tax cases under Schedule D, to a body which is not made up of local people who might profit from a knowledge of the intimate facts revealed in the course of hearings on assessments. There are at present seven of these special commissioners. They are permanent, paid officials appointed by the Lords of the Treasury and are in no sense subordinate to the Board of Inland Revenue. Their salaries range from £850 to £1000. They maintain headquarters in York House, London, where they hear appeals but in order to serve the convenience of taxpayers they

[278] Finance (No. 2) Act, 1915, sec. 45 (5). For special provisions referring to Ireland and to the statement of a case on a point of law, *cf. infra,* Appendix A, II. Appeals in cases of profits on trading stocks go to the income tax commissioners (general or special). Finance Act, 1918, sec. 35 (3). In the case of certain shipping profits the appeal is to the Special Commissioners alone. *Ibid.,* 1916, sec. 47 (b); *ibid.,* 1917, sec. 22 (2), *infra,* Appendix A, IV.

[279] *Cf. supra,* p. 119.

[280] *Cf.* Testimony of Sir Thomas Collins, Cmd., 288-1, p. 14 *et seq.*

also go on circuit from time to time, two commissioners forming a quorum.[281]

The procedure before these commissioners is not elaborate. Around a table meets a group consisting of the taxpayer, represented by counsel if he chooses, the General Commissioners with their clerk who is often a trained lawyer, or the Special Commissioners with a special legal representative of the Crown if the case is important, the surveyor who has striven in vain to effect an agreement both before and after the assessment and through the assistance of his supervising inspector. Witnesses may be called and examined under oath. Decisions arrived at under these circumstances give general satisfaction. The taxpayer feels that he has had a hearing under fair conditions for it is for him alone to decide whether he prefers to have his case settled by the board made up of his friends and neighbors or by a Treasury body independent of the Inland Revenue.

The British are very much attached to the Boards of General Commissioners and are jealous of any movement to shear them of any of their powers to adjust cases on appeal. Although as has been seen, their powers of original assessment have largely been taken over by the Surveyors, their position on appeals is still very strong.

Appeals to the Board of Referees.—The Board of Referees constitutes the most distinctive contribution made by the Excess Profits Duty to the British administrative organization. It is, in fact, the only body which was set up especially for the purposes of this Duty. Its worth has been amply demonstrated by the satisfactory manner in which it has solved the difficult problems assigned to it. Its existence has resulted in the accomplishment of certain ends which could not possibly have been gained through ordinary departmental machinery, even as modified for purposes of the Duty. It will undoubtedly remain as a permanent part of the British organization even though the Excess Profits Duty disappears.

The idea back of the Board of Referees is essentially that which is responsible for the British arbitration courts for commercial disputes. It is the notion that on certain questions a decision can best come from a disinterested group of umpires familiar with

[281] These special commissioners make all of the income tax assessments in Ireland.

the complicated conditions under which business operates and free from the bureaucratic bias of the administrator or the doctrinal bias of the lawyer.

We have nothing in our organization which compares with this body. The Excess Profits "Advisors" and "Reviewers"—now no longer in existence—constituted our nearest approach, but they were, after all, Treasury officials even though their outside connections and brief official tenure gave them a certain degree of detachment and freedom from the bureaucratic point of view. Our present Committee of Review and Appeal is purely a departmental organization with no trace of the arbitration element in its constitution. During the war the "advisors" and "Reviewers," in spite of their organic connection with the assessing authority really functioned to a limited extent as the Board of Referees functions in Great Britain and their efforts were deeply appreciated and approved by American taxpayers. Without their efforts the administration of the statute would have been practically unendurable. The British have this element organically incorporated into their system in a form much superior to that we utilized.

Constitution of the Board of Referees.—It is the general aim to have the Board of Referees consist of one or two men trained in the law to preside, about twelve accountants and twelve business men. The business men are selected from various branches of industry and from all parts of the country. Nominations for a certain number of places on the Board are invited from the Chambers of Commerce. Membership is a mark of honor and distinction. Appointments are made by the Treasury and members are paid no salary but receive an honorarium of two guineas per day for expenses. The following list of the members of the Board as constituted in March, 1917, will give a conception of their high calibre and standing:

Sir Charles Bine Renshaw, Bart., Scotland, Chairman of Caledonian Railway and Carpet Manufacturer (Chairman).
Lord Faber, Yorkshire, Banker.
Sir Clarendon Hyde, London, Partner in Pearsons, Contractors.
A. F. Pease, Yorkshire, Coal and Iron.
J. H. Tritton, London, Banker (Barclay's Bank).
Leif Jones, M.P., Lloyd's.
F. W. Gibbons, South Wales, Tin-plate.
J. E. Fottrell, Dublin, Director of Royal Bank of Ireland.
Alexander Cooke, Belfast, Flax and Yarn Merchant.

H. Woodburn Kirby, London, President of the Institute of Chartered Accountants.
A. C. Miles, Manchester, ex-President of the Institute of Chartered Accountants.
R. H. March, Cardiff, Accountant.
W. H. Cook, Scotland, President of the Scottish Chartered Society of Accountants.
Sir William Peat, Accountant (Shipping).
C. Hewetson Nelson, Liverpool, President of the Society of Incorporated Accountants and Auditors.
W. T. Walton, West Hartlepool, Accountant.
Sir Jeremiah Colman, Bart., London and Norwich, Mustard, Starch and Blue Manufacturer.
C. D. Morton, London, Chairman of a firm of Manufacturers, Exporters, and Dealers in Provisions.
Howard Williams, London, Chief Partner in Hitchcock, Williams and Co., Wholesale Drapery Warehousemen and Retailers.
W. Penrose-Green, Leeds, Locomotive Builder.
L. F. Massey, Manchester, Chairman of Engineering Works.
Walter Tyzack, Sheffield, Cutlery Manufacturer.
J. A. Jones, Cardiff and Newcastle, Shipping.
A. W. Faire, Leicester, Boot and Shoe Manufacturer.
William McLintock, Accountant, Glasgow.
Edward Manville, of London and Coventry, President of the Associated British Motor Manufacturers.
D. M. Kerly, K.C., London.
A. W. Wyon, Accountant, Partner in the firm of Price, Waterhouse and Co.

It will be noted that there were 28 members at this time distributed among the various professions and businesses as follows: Manufacturing, 9; accounting, 9; banking, 3; mercantile, 2; law, 1; contracting, 1; mining, 1; shipping, 1; and insurance, 1. Two years later, July 31, 1919, the constitution of the board remained unchanged except for the absence of the names of Sir Charles Bine Renshaw and A. F. Pease and the addition of W. F. Clark, a mining engineer. Mr. Kerly is now chairman. The further enlargement of the board was under consideration at this time.[282]

The cause assigned for the discontinuance of our Advisory Tax Board was the inability of the Treasury to enlist the services of men of the proper stamp. Service on that board meant accepting a full-time position as a treasury official and devoting one's entire effort to the work. Service on the British Board of

[282] Royal Commission on the Income Tax, 1919, Cmd. 288-1, p. 67, footnote.

Referees involves no such sacrifice. Instead of being overwhelmed by a multitude of individual cases, the time of the Board is conserved by the delegation of all but the most important matters to the Board of Inland Revenue and the General and Special Commissioners. The total number of appeals which they have actually entertained amounts to only about one hundred. Moreover, the entire board does not sit, for it has been found feasible to divide its membership into panels of a half-dozen members, so that, although there have been about forty meetings of the Board in all, it has been necessary to ask the individual members to give only about ten days apiece to the work. Immediately after its establishment the Board met frequently and for all-day sessions. Since the first rush of appeals, the meetings have been held infrequently and have lasted only a few hours.

Cases Subject to Appeal to the Board of Referees.—As has been shown above,[283] appeals to the Board of Referees fall into three general classes:

(1) A taxpayer dissatisfied with the modifications made by the Commissioners of Inland Revenue under authority of Section 40 (3) in the rules of the Fourth Schedule[284] as applied to his case may insist that his appeal be referred to the Board of Referees.[285] The Commissioners have no power to intercept such an appeal. They must refer every one to the Board. It is to be noted that such appeals come from individual taxpayers rather than from classes of trade of business.[286]

Most of the appeals under this section have had to do with modifications due to a change in the constitution of a partnership. Thus far the Board of Referees has not granted a single appeal of this type, the adjustments made under Part II of the Fourth Schedule having proved sufficient to meet the situation.[287] A number of appeals for modifications based on war causes are expected in the course of the adjustment of industries to post-war conditions.

283 *Cf. supra,* pp. 115-116.

284 *Cf. infra,* Appendix A, II. The Finance Act of 1917 (sec. 55) provided for the reference of certain questions arising in connection with the assessment of controlled establishments to referees appointed by the Minister of Munitions.

285 *Cf. supra,* pp. 117-118.

286 *Ibid.*

287 *Cf. infra,* Appendix A, II.

(2) By an amendment to the income tax law passed in 1918,[288] "where an application has been made to the Commissioners of Inland Revenue for the alteration of the amount of any deduction for wear and tear, the Commissioners, unless they are of the opinion that the application is frivolous or vexatious, shall refer the case to the Board of Referees." These are cases of ordinary depreciation rates. In such appeals that Board, "if satisfied that the application is made by or on behalf of any considerable number of persons engaged in any class of trade or business" takes the application into their consideration and determines the deduction to be allowed.[289]

In the summer of 1919 the writer was informed that there had not yet been any cases before the Board under this section.

(3) Finally in certain cases where the Commissioners of Inland Revenue have no authority at all to make modifications, they act as an intermediary in presenting appeals to the Board of Referees, weeding out certain cases in the process. Such cases are those included within the terms of the following section of the law:[290]

42. "Where an application is made. . . .

(1) For an increase in the statutory percentage as respects any class of trade or business or for a calculation of the percentage standard in the case of any class of trade or business in which the amount of capital actually employed in the trade or business is, owing to the nature of the trade or business, small compared with the capital necessarily at stake for that trade or business, by reference to some factor other than the capital of the trade or business or to some additional factor: or

(2) For an alteration of the pre-war standard of profits as respects capital employed for the purpose of the manufacture of war materials or for munitions work and which could not be expected to be remunerative or wholly remuner-

[288] Finance Act, 1918, sec. 24 (1). *Cf.* also, Income Tax Act, 1918, 8 and 9, Geo. 5, Ch. 40, Schedule D, Cases I and II, rule 6 (7).

[289] Moreover in the codification of the income tax accomplished in 1918 (8 and 9 Geo. 5, Ch. 40) an appeal is given to "a referee or board of referees to be appointed for the purpose by the Treasury" in cases of dissatisfaction with an income tax assessment based on a percentage of turnover. Income Tax Act, 1918, All Schedules Rules, no. 9.

[290] Finance (No. 2) Act, 1915, sec. 42.

ative, except in time of war, in a business which has been wholly or mainly carried on for those purposes."

An appeal falling within this class is filed with the Commissioners of Inland Revenue who refer it to the Board of Referees unless "they are of the opinion that the application is frivolous or vexatious or relates to matters already decided by the Board of Referees."[291] Moreover, the last phrase regarding matters already decided does not prevent the Commissioners from referring back to the Board of Referees any matters already decided by the Board in cases affecting classes of trade or business,[292] which, in their opinion, deserve reconsideration or review, this point being specifically covered by an amendment passed in 1917.[293]

As a matter of fact, the Commissioners of Inland Revenue have never exercised their power to intercept an appeal as frivolous or vexatious. They have attempted to dissuade petitioners when they considered that the appeals were lacking in merit but they have in no case refused to transmit an appeal to the Board of Referees.

It will be noted that there are really three types of applications included in this third class:

(a) Appeals for an increase in the statutory percentage;
(b) Appeals for the calculation of a special percentage standard and
(c) Appeals for the alteration of the pre-war standard of munitions concerns.

Most of the appeals considered by the Board of Referees have fallen in group (a)—applications for increases in the statutory percentage in a "class of trade or business." The action of the Board on these appeals is treated in detail in sections which follow.[294]

Very few applications have been received in group (b), appeals for the calculation of a percentage standard by reference to some other factor than the capital in cases where the capital invested is small compared with the capital at stake. This section was originally designed to meet the objections of those engaged in underwriting risks and does not apply to cases where the total

[291] Finance (No. 2) Act, 1915, sec. 42.

[292] Note that this permission is not extended to cases falling under (2) above.

[293] Finance Act, 1917, sec. 25.

[294] *Cf. infra,* p. 130 *et seq.*

capital at the risk of the business is small compared with the profits. In only two cases have such special standards been set up by order of the Board. They are the businesses of underwriting and insurance (fire, accident, and general, not including life or marine). The "other factor than the capital" selected as the base for the calculation of the percentage standard in the case of the specified insurance companies was taken to be the net premium income and the standard was to be ascertained by applying the statutory rate to an amount equal to one-half of that income for the year at the end whereof capital is to be reckoned.[295] In the case of the marine insurance companies the amount of the entire net premium income for the year was taken in place of the invested capital.

The powers of the Board with reference to appeals falling in group (c)—munitions concerns—have apparently not been exercised, the determination of equitable allowances having been accomplished by other methods.

It is evident, then, that the activity of the Board has been restricted almost exclusively to the consideration of appeals from classes of trade or business for increases in the statutory percentage.

"Class of a Trade or Business" Defined.—An application to the Board of Referees for an increase in the rate of depreciation, the statutory percentage or for the calculation of a special percentage standard is entertained only when it is presented by a class of trade or business. This phase is defined in the statute so as to extend the permission to appeal to "any subdivision of a trade or business based either on any special feature of the trade or business or on locality . . . in any case where the Board of Referees are of opinion that the subdivision can properly be dealt with separately."[296]

The interpretation of this definition of "class of trade or business" is made by the Board of Referees in the course of its decisions as to whether it will entertain particular appeals from individual concerns who maintain that they should be treated as a class or as a subdivision of a class. However, if it is admitted that the class includes other concerns, an appeal from a single concern is not considered even though it be contended that the

[295] *Cf.* Appendix D.

[296] Finance (No. 2) Act, 1915, sec. 42.

appealing taxpayer is the only member of the class which has earned enough to make it liable for Duty or that competition among members of the class is so bitter as to prevent combination for purposes of a collective appeal or other general trade purposes. It is understood, however, that, while a petitioner must speak on behalf of all or the bulk of his class of trade, the Board would probably not refuse to hear an appeal in a case where as many as 25 per cent of the concerns failed to support the petition.

When a single concern appeals to be considered as a class on the ground that it is the only concern engaged in the business in a given locality, it must be shown conclusively that there are factors of location which affect the enterprise so fundamentally as to make it truly unique. Thus a group engaged in bootmaking in a Scotch village was discouraged from appealing as a class while a favorable award was made in the case of an appeal of a single concern engaged in mining chrome ore on an island in mid-ocean.

It is difficult to persuade the Board of Referees to recognize an appeal from a single individual who refines the definition of his subdivision or class by restrictions consisting of references to the "special features" of the business. It is understood that the Board insists that such "special features" shall not be merely accidental but shall be incidents in the nature of special risks connected with the trade of really substantial importance in their effect upon the amount of the Duty.

The classification of business, however, is sometimes carried to a high degree of refinement. For example, the Board has recognized distinction between no less than three types of tin mining in Malay. The statutory percentage was made 13 and 14 per cent in the case of concerns engaged in "the mining of alluvial tin in the Federated Malay States (not including mining by operating bucket dredges)" while it was made 16 and 17 per cent in the case of concerns "mining lode tin in the Federated Malay States." The rate was made 13 and 14 per cent in the case of concerns engaged in the "mining of alluvial tin in the Federated Malay States and Siam by operating bucket dredges." There were still additional classes consisting of the tin mines in Nigeria and those in the United Kingdom.

The collection of evidence and the conduct of appeals naturally falls to a considerable extent within the province of existing trade

organizations. The officials of the London Chamber of Commerce, for example, stated that they had prepared the cases for several classes of business and had represented the class before the Board of Referees.

It is apparent that a reduction through appeals to the Board of Referees is never obtained merely because of the fact that the appellant is subject to a large tax. Relief can be secured only in case where the taxpayer can show that, for some reason inherent to the nature of the business, he deserves a higher standard. Moreover an individual concern can secure a hearing only in a case where it is in the unique position of being absolutely the only representative of a class of trade or business as above defined.

Orders of the Board of Referees.—When an order is made by the Board of Referees which increases the statutory percentage or alters the percentage standard "as respects any class of trade or business" the statute states that the increases and alterations shall be made "as respects any trade or business belonging to that class."[297] Orders of the Board of Referees establishing special percentage standards or increasing statutory percentages are published in the London *Gazette.*

The practice contrasts sharply with ours under which relief is never extended to classes by administrative action but only to individual cases upon individual application. Much injustice is caused here by this rule because relief is often extended to one concern and not to another, similarly circumstanced, because the first, aggressive and well-advised, happened to push a claim for relief while the second, because of ignorance, inertia or expense, failed to do so.

Orders of the Referees are effective as from the date specified in the order.[298] It is the custom in the case of special percentage standards to grant the increases from the time when the original act went into effect.

General Procedure Before the Board of Referees.—All appeals to the Board of Referees pass through the hands of the Inland Revenue. The statute, however, does not prescribe what shall be the position of the Inland Revenue in a hearing before the Board of Referees. As a matter of practice, the Inland Revenue makes every effort to make an adjustment to the extent of its statutory

297 Finance (No. 2) Act, 1915, sec. 42.
298 *Ibid.*

authority and as a result the Referees hear the case only after the issues have been sharply defined and the facts carefully prepared. The case is either one where the Inland Revenue thinks that the taxpayer is asking for a modification which is unreasonable—when the Referees must virtually take a position of an arbitrator and decide between the parties to the dispute; or the case is one where the class of business is asking for an increased statutory percentage—when the Board of Referees is very eager to have the Inland Revenue appear as a "friend of the court" in order that it may receive its advice as to what increase, if any, should be granted. Consequently the Inland Revenue is always in the midst of the proceedings before the Referees. As a matter of fact the final preparation of the appeals is usually done by the technical staff of the Inland Revenue. Often as a result of the preliminary discussions, the appealing trade and the Inland Revenue present a united front, the trade preferring to modify their demands in order to secure the advantage of the hearty support of the Inland Revenue at the hearing before the Board of Referees. The recommendations of the Inland Revenue always carry great weight with the Board. Indeed the officials could recall no case in which an appeal had been granted contrary to their advice, except one in which the Board of Referees declined to grant as liberal relief as the Inland Revenue was prepared to concede!

When the Commissioners of Inland Revenue receive an appeal to the Board of Referees, they examine it to make sure that it is in regular form and attach a statement setting forth the extent to which they are prepared to admit the facts as stated. Then, if there is any dispute as to facts, there is an interlocutory appointment with the chairman of the Board of Referees at which the appellant receives definite directions as to issues which should be raised and as to supporting evidence which should be submitted. Two weeks before the final hearing, proofs of the evidence are exchanged between the Inland Revenue and the appellant and eight days before the hearing they are filed with the Referees. About two-thirds of the cases are decided without oral argument before the Board. The decision is given in writing on the day of the hearing. Only three weeks are ordinarily required to carry a case from the notice of appeal to the final decision.

Increased Statutory Percentages—General.—The British

statute recognizes much more frankly than our own the great diversity of business and the consequent necessity for elasticity of treatment. Probably the actual range of conditions is greater in the case of British business than in our own, due to the extensive colonial developments. Then, too, under the British income tax procedure, with its limited recognition of depreciation and its entire disregard of depletion and capital losses, it was even more important than in our case that the statutory percentage be made flexible. However, a given percentage of return on invested capital could not hope, in either England or America, to apply equitably to all classes of business. In establishing their procedure for introducing the necessary elasticity the British have distinctly surpassed us. Relief is extended systematically and uniformly. Our relief is neither systematic nor uniform.

The Board of Referees does not announce the basis upon which it rests its decisions as to whether increased percentages shall be granted. This is in conformity with the general theory of British Tax administration that the taxpayer should proceed to carry on his business and make up his accounts as he would if there were no tax in existence. Too detailed knowledge of the procedure, it believes, encourages the rigging of accounts and the warping of the form of transactions in an attempt to avoid the tax.

It is understood, however, that in considering appeals for percentages in excess of that established in the statute the Board bases its decisions on the theory that this portion of the tax is distinctively an excess profits tax with an invested capital standard rather than a war profits tax with a pre-war standard. What such concerns are accustomed to earn is considered beside the point, although what such concerns are accustomed to lose is considered the best possible evidence regarding the degree of risk involved. The real question is whether there appear to be any circumstances surrounding this class of business which makes it economically necessary for them to receive an abnormally large return on their invested capital.[299] The special circumstances which appear to be considered of most importance are depletion, deferred yield and risk. Depletion is adequately cared for in this country through the allowance of full deductions in arriving at

[299] *Cf. supra*, p. 17, footnote 63.

taxable profits.[300] In Great Britain depletion is not recognized as a proper deduction[301] and in making comparisons the fact that the statutory percentage includes depletion must always be kept in mind. Here we make no specific modification for the deferred yield or for risk. With respect to deferred yield, we do not even give the recipient the reliefs granted under the British provisions regarding capital temporarily non-productive and set offs and refunds for bad years, to say nothing of this special arrangement for an increased statutory percentage. With respect to risk it is true that, under our different concept of income, we do permit the deduction of capital losses, but it is obvious that our rigid scheme of taxing the result of each year's operations without reference to what has happened before or what may happen thereafter effectually prevents risk from being taken fully into account even for an industry as a whole. Moreover, the irregular distribution of the losses among the individual concerns in a given industry makes it inevitable, in the absence of general relief such as the British give, that our excess profits tax should in some cases fall upon what are, in effect, nothing more or less than insurance funds. This fact is implicitly recognized in our law when we extend to mining and oil companies the right to calculate depletion on a special arbitrary basis. This is merely a bunglesome attempt to recognize a factor which the British take into account in a straightforward scientific manner. For example, who may deny that the British special allowance of an additional 2½ per cent in the case of California oil producers is a more practical solution than our special depletion allowance on the basis of value after discovery?

An inspection of the published decisions of the Board of Referees makes it evident that it does not hesitate to increase the statutory percentage when an enterprise is subject to risks such as great distance from home supervision, exposure to unsettled political conditions[302] and the presence of unusual rates of depletion. In the case of very risky ventures the statutory percentage is increased to a point which is startlingly high as compared with our modest 8 per cent allowance. The highest awards by the British Referees have been a percentage of 29½ per

[300] *Cf.* Revenue Act of 1918, secs. 214, 234.

[301] *Cf. infra,* p. 55.

[302] *E.g.,* oil raising in Burma, 2½ per cent additional; oil raising in South Russia, 8 per cent additional.

cent[303] on pre-war capital and 32½ per cent[304] on new capital, but this was for a mining venture in which no depletion was deductible except through this percentage.

Applications from mercantile undertakings at home have not fared well before the Board of Referees. The great majority of the cases favorably received have been undertakings abroad.

It occasions surprise that a list of applications which includes such narrowly defined classes of business as "oil raising in Assam," "lending money on mortgage in Mauretius," and "theaters in the West End of London," should be as short as it is, containing in all only 131 items. If England with her wider range of undertakings can meet the problem of the adaption of profits taxation to special types of business with so slight an expenditure of effort, it is interesting to speculate as to what might be accomplished in equalizing the tax in this country if, say, only a dozen special classes of business were recognized and special percentages granted. The Treasury is already in the possession of data which should be of great assistance in determining what these percentages should be.

List of Increased Statutory Percentages.—The following is a complete list, so far as the writer has been able to check it, of the increases in statutory percentages granted by the Board of Referees. The figures given relate to corporations and represent the increase over the basic 6 per cent general allowance. Unincorporated concerns originally received an additional one per cent which figure was increased to two per cent as of January 1, 1917. From the same date in the case of new concerns and of new capital in old concerns the old 6 per cent rate was increased by two per cent as of January 1, 1917. From the same date in the case of new concerns and of new capital in old concerns the old 6 per cent rate was increased by 3 per cent which was to apply in addition to any special allowances made by the Board of Referees.[305] Consequently, to arrive at the total allowance for a concern included in one of the classes in the following list, 6 per cent should be added if it is a corporation and 8 per cent if it is a partnership, with 3 per cent more if it is a new concern or if the item is one of capital recently invested.

[303] These rates apply to unincorporated ventures.

[304] This is increased one per cent under the proposed 1920 legislation.

[305] *Cf. supra,* pp. 91-93.

	Additional Percentage
Aeronautical instruments, manufacturers of	*nil*
Agriculture in Greece	6
Aircraft manufacture	9
Antimony mining and smelting in Mexico	11
Antimony smelting	*nil*
Asbestos mining in Rhodesia	10
Balata, collection, preparation and sale of	4
Boot making	*nil*
Cement manufacture, excluding cement for plastering, etc	½
Chrome ore mining in New Caledonia	16½
Cinemas	5
Coal mines in Bengal	4
Coal mines in Great Britain	3
Coal mines in Rhodesia	4
Coal mines in Union of South Africa	3
Cocoanut growing in the Middle East	4
Cocoanut growing in British West Indies	5½
Cocoanut and palmyra palm manufactures in Southern India and Ceylon	2½
Coke manufacture in Rhodesia	3
Coke manufacture in the United Kingdom	2
Cold storage	1½
Copper mining in California	4
Copper mining in Chile	4
Copper mining in Rhodesia	9
Cotton production in the Sudan	6
Electric light and power at Hankow	3
Electric supply in India	1
Electric supply in London	1
Electric supply in the Provinces, etc	1½
Electric supply in Victoria	1½
Electric traction at Shanghai	3
Electric tramways in Cape Colony	1½
Electric tramways in India	1
Electrical cable manufacturers	1
Electrical and pneumatic power in Transvaal	3
Electrical machinery, etc., manufacture of	1
Electrode manufacture	*nil*
Engineering in Bengal	2
Erinoid manufacture	1½
Explosives, manufacture of	2
Flax preparation in Great Britain	4
Flour milling in South America	1½
Gas mantles, manufacture of	3
Gold mining in British India	21½
Gold mining in Colombia	9
Gold mining in Egypt	21½
Gold mining in Rhodesia	16½
Gold mining in West Africa	16½
Grain export from the Argentine	1½
Hosiery manufacture	nil
Importers of table glassware	*nil*
Indigo growing	6
Iron and steel manufacture in Bengal	4
Iron ore mining in Algeria	8
Iron pyrites in the Iberian Peninsula	*nil*
Jute merchants	*nil*
Jute spinning, etc., in Bengal	1
Lead mining in Western Australia	8

	Additional Percentage
Lending money on mortgage in Mauritius	1½
London omnibuses	2
London wholesale tea and coffee dealers	*nil*
Magnesite mining in Greece	4
Magnet manufacture	5
Magneto manufacture	5
Manganese ore mining in Great Britain	10
Manganese ore mining in India	4
Mangrove products (Borneo)	4
Marine salvage	9
Merchants in Philippine Islands	1½
Military Ornaments, etc., manufacture of	2½
Mining in Burma	6½
Motor manufacture	1
Music halls	5
Myrabolom production in India	5
Newspapers (mainly dissemination of news and not comment on) in Scotland	2
Newspapers (England, Wales and Ireland)	2
Nickel mining in New Caledonia	2
Nitrate extraction in Chile	3
Oil producing in California	2½
Oil producing in Trinidad	8
Oil raising in Assam	2
Oil raising in Burmah	2½
Oil raising in Caucasus	4½
Oil raising in Persia	5
Oil raising in Peru	2½
Oil raising in Roumania	2½
Oil raising in South Russia	8
Paint, colour and varnish manufacture	*nil*
Pig iron, manufacture of	1
Portland cement manufacture in South Africa	2½
Potato flake manufacture	*nil*
Provincial omnibuses	2
Quebracho tree, extraction of essences from	3
Road-making material, manufacture of	2½
Rubber goods, manufacture of	*nil*
Rubber growing	4
Rubber production in Bolivia	4
Salt, production of	1½
Shale	3½
Sheep-farming in Chile and Patagonia	5
Shipping, specially designed	*nil*
Silica ware, manufacture of	2
Steel manufacture	2
Stevedores	*nil*
Straits Plantations, Ltd.	4
Sugar growing in Argentine	5
Sugar growing in British India	5
Sugar growing in Mauritius	5½
Sugar growing in Natal	5½
Sugar growing in Portuguese East Africa	5½
Sugar growing in West Indies, etc.	5
Sulphide mining in New South Wales	3½
Synthetic dyestuffs, production of	3
Tea growing and manufacture in British India and Ceylon	2
Tea growing and manufacture in Netherlands, East Indies	2
Telephone service in Chile	1½

	Additional Percentage
Theaters in the West End of London	9
Theaters elsewhere than in the West End of London	5
Thoroughbred breeders	7
Tin dredging in Malay and Siam	7
Tin mining in Malay	7
Tin mining in Malay (Lode tin)	10
Tin mining in Nigeria	7
Tin mining in United Kingdom	19
Tramways and light railways	1½
Tramways in New Zealand	1½
Tramways in Victoria	1½
Tungsten, etc., manufacture of (for high-speed steel)	6
Tungsten and molybdenum, manufacture of	6
Wattle growing in Natal	3
Wolfram mining in Portugal	5
Wood pulp manufacture in Portugal	2
Zinc oxide manufacture in United Kingdom	6

Success of the Board of Referees.—In the course of the budget debate on May 2, 1917, Mr. McKenna took occasion to bestow high praise upon the Board of Referees in the following words:

"It is only fair that our attention should be drawn to another factor which has greatly facilitated the operation of the tax. One of the elements of great doubt was the settling of disputed questions by particular trades as to what their allowances should be in the way of interest. The settlement of that question in regard to each trade was referred to a body of referees set up and presided over in the first instance by my right hon. Friend the Irish Secretary, whom I am glad to see in his place. The very great ability and celerity with which that work was done far exceeded the anticipations which were formed at the time, with the result that the Treasury had been able to collect not far short of double the amount which we estimated would come in in April last."[306]

The approval of the Board here expressed is re-echoed from every quarter. The officials of the Inland Revenue testify that it has proved to be an invaluable part of the machinery. Even though its function appears on the surface to be a somewhat mechanical "rubber stamping" of the recommendations of the Inland Revenue, as a matter of fact the sanction of the Referees is something very vital and important and their attitude toward a particular question can never be definitely foretold. At any time the Board may insist upon something very different from what the Revenue desires. The public generally has the

[306] Debates, 93: 395-6.

greatest confidence in the Board. The business men consider it their especial representative. The Association of British Chambers of Commerce, in giving evidence through Sir Algernon F. Firth, Bt., before the Royal Commission on the Income Tax, referred to the Board with approval as a body which "has had and is having a most valuable experience" and recommended the extension of its functions for income-tax purposes.[307]

Decisions of the Board are accepted gracefully. To complain about an award, when the proceedings are conducted essentially as an arbitration, is considered to be very "bad form." The writer heard of only one case where a trader had failed to accept his decision with good grace and he was quite frankly dubbed a "poor sport" by the business man who mentioned the occurrence.

Summary

The chronological account of the development of the statute given in Part One (pages 1-24) renders it unnecessary to summarize the statutory provisions again at this place. It remains, however, to indicate those points in the British procedure and organization which are particularly interesting and suggestive to students of the American problem.

The most troublesome problem encountered in the administration of our excess profits tax has been, of course, the equitable treatment of the abnormal cases. The main provisions of the law are necessarily framed with the typical normal case in view and if a concern has no particular features the application of the tax usually occasions no great hardship. However, real distress and inequity often does appear when the invested capital cannot be readily determined; or when, because of the nature of the business or because good-will has been excluded under the arbitrary limitation, the invested capital bears slight relationship to the profits; or when an ordinarily large sum is realized in a single year, perhaps as the result of the sale of a capital asset, and under various other special circumstances.

Indeed a very large percentage of the cases appear to deserve special consideration and treatment. Our attempts to care for these abnormal cases have not given satisfaction. We have found it difficult to introduce the desirable elasticity into our statute and to utilize such elasticity as exists in a broad and fair spirit.

[307] Monthly Proceedings of the Association of British Chambers of Commerce, July 1919, No. 653, p. 60.

The threatened breakdown of our administration is traceable in large part to this situation. A taxpayer who is convinced from his experience with the Treasury that the Government either cannot or will not give him equitable treatment will be inclined to take measures to protect himself and will ordinarily have few qualms of conscience if those measures fail to square with the spirit and the letter of the law.

Our system is inflexible. It attempts to apply the tax by fixed and arbitrary rules. Small discretion is vested in our administrative officers. Such relief measures as are embodied in our law are hedged about with restrictions so numerous as to thwart their purpose. We take tremendous taxes in prosperous years and make no allowance for abnormally poor years in the individual history of an enterprise. The principal relief sections (Sec. 210 of our 1917 law and Sec. 328 of our 1918 law) are administered by Star Chamber proceedings. The taxpayer is assured that he has been assessed on the basis of representative concerns but is denied any information as to the identity of the concerns chosen as representative. He often feels (perhaps without justice) that he has been assessed on no basis whatever except the judgment of the administrative officials, a judgment that may have been tempered by sympathy for his plight or adversely influenced by considerations outside the scope of a taxing statute. He knows that in any trade or business individual instances of large earnings (and consequently heavy taxes) or of small earnings (and light taxes) may readily be found—and consequently that "representative concerns" may be selected within a wide range. It is natural for him to assume, therefore, that the power to assess him is arbitrary, practically unchecked and wholly contrary to our American principles of taxation. Nor is his criticism entirely without foundation. Under the sections referred to exists virtually the power to tax without certain and definite restraint. On the other hand, the provisions are ineffective to grant relief in many cases, for the measure of relief is the tax paid by representative concerns, a matter which may be entirely immaterial to a particular case. We have in these provisions a makeshift which serves to confer too great discretion in some cases and too little power to grant relief in other cases. Our solution of the problem in abnormal cases should lie in a consideration of the abnormal factors and their adjustment to fit the scheme of taxation as applied to normal cases.

The British appear to have achieved success where we have failed, for it is clear that they have been able to solve the problem of the abnormal case with a fair degree of satisfaction to all concerned. How they have met this problem is really the theme which runs through the entire Part Two of this report.

The statute itself is very broad in character, contenting itself with general indications as to how the administrators shall proceed in solving the specific questions which arise. The act is fully "cushioned." At every point in the procedure provision is made for dealing with exceptions. The machinery of assessment is constructed with a view to giving expert assistance to the taxpayer in arriving at his liability and is animated with a spirit of reasonableness and with an eagerness to achieve equity. Amazingly wide discretion is vested in the administrative officials and a very complete series of appeals are available to taxpayers who are dissatisfied with the manner in which that discretion has been used. The collection of the Duty is postponed, interest-free, in cases where prompt payment would cause hardship. The calculation of invested capital, while in some cases more narrow than ours, is almost entirely free from the arbitrary restrictions and limitations which hedge about that process under our statute. In the determination of taxable profits very different principles (*e.g.* the conception of the accounting period which permits losses to be charged back to previous years—and the interpretation of the term profits in such a manner as to exclude capital gains) govern the procedure with the result that many of our "hard cases" never arise. Special relief is given both to general classes of trade or business and to individual taxpayers but more care is taken there than here to apply relief to all taxpayers within a class.

Attention is directed particularly to the sections of the preceding discussion which deal with the following topics: the additional statutory percentages granted upon appeal;[308] the provisions for losses;[309] the concessions granted in connection with trading stocks (inventories);[310] the wide discretion vested in the administration to grant relief in cases of unusual depreciation, obsolescence, postponed repairs, etc.;[311] the recognition of patents

[308] *Supra,* p. 130, *et seq.*
[309] *Supra,* p. 45, *et seq.*
[310] *Supra,* p. 57, *et seq.*
[311] *Supra,* p. 50, *et seq.*

and secret processes as material assets and the general absence of restrictions upon the computation of invested capital;[312] the assessment organization and policy designed to eliminate indefiniteness and uncertainty[313] and the very elaborate and satisfactory appeal system.[314] The various provisions which make the British law elastic are so widely scattered in the text of this report that the following summary may serve a useful purpose in emphasizing their extent and importance. The rigor of the statute is mitigated:—

1. In the case of small but profitable concerns with low pre-war standards, by the operation of the special provisions regarding the initial exemption;[315]

2. In the case of concerns with irregular income (a) by the absence of progressive rates which have the effect in this country of making the total tax heavier upon a concern with an irregular income than upon one whose income accrues regularly, (b) by the fact that one great cause of irregularity of profits—the falling-in of capital gains—is practically eliminated, (c) by the abandonment of the conception of profits as an annual gain through the general permission to reduce the profits of preceding years to the extent that profits in later years are abnormally low, through the recognition as a deduction for purposes of the Excess Profits Duty of any profits[316] applied to the extinction of a net loss during the pre-war years and the permission to charge back inventory losses realized after the Duty ceases to operate and (d) by sanctioning a very reasonable allocation of long-term contracts;

3. In the case of concerns owning capital which was unremunerative before the war, by a modification in the profits standard sufficient to increase the return on such capital to the level of the statutory percentage;

4. In the case of concerns subject to the tax on investment income, by permitting the deduction of unrealized losses in capital value of securities in so far as they are due to variations in the value of money;

312 *Supra*, p. 80, *et seq.*

313 *Supra*, p. 98, *et seq.*

314 *Supra*, p. 115, *et seq.*

315 Their sliding scale, however, gives them less relief than our own flat exemption of $3000. *Cf. supra*, p. 33 *et seq.*

316 Unless the percentage standard is used, the capital account must show a debit balance if the deduction is to be made.

5. In the case of trades which operate under conditions of unusual waste, risk or deferred returns, by permitting appeals to the Board of Referees for increases in the statutory percentage;

6. In the case of concerns operating under war conditions, by special allowances for depreciation, postponed repairs and obsolescence upon appeal to the Commissioners, with further appeal to the Board of Referees;

7. In the case of concerns whose invested capital, because of the nature of the business, is small compared with the capital necessarily at stake, by permitting an application to the Board of Referees for a special percentage standard;

8. In the case of new agencies and similar concerns, by permitting the use of the income of the agent during the pre-war period from any "trade, business, office, employment or profession of any sort" whether liable to Excess Profits Duty or not, carried on by the agent or other person before his new trade or business commenced.[317]

9. In the case of new concerns which began before the war but too recently to have established a full pre-war trade year, by permitting them a standard establishment by applying the 9 or 11 per cent rate to all capital instead of insisting upon the 6 or 8 per cent rates on such portion of the capital as was invested at the end of the last accounting period before the outbreak of the war.

10. In the case of concerns which have changed ownership since the commencement of the three last pre-war trade years, by giving them the option of being treated as a new concern or of retaining the profits standard of the old concern;

11. In the case of munitions concerns, by permitting them to appeal to the Board of Referees for a special profits standard;

12. In the case of a concern with pre-war losses, by authorizing the Commissioners to ignore pre-war losses when several industries are operating under one management and are using the profits standard and by permitting recognition as invested capital of former assets which have disappeared or of indebtedness which has increased when there have been trading losses in the pre-war years and the percentage standard is used; and

13. In the case of concerns generally, by the alternative pre-war standard with the option in favor of the taxpayer, rather than against him, by the more narrow definition of profits, by the

[317] For limitation, *cf. supra,* p. 75.

almost total lack of restrictions upon the recognition of assets as invested capital, by the liberal provision for adjustments in special cases, by the convenient and complete appeal system, and, finally, by the capable and adequate administrative organization functioning with a spirit of liberality and fairness.

How far it is possible for us to follow British precedents with our different institutions and our different general conditions is a question but it is apparent that the British procedure is full of suggestions for the improvement of our own.

PART THREE

FISCAL AND ECONOMIC CONSEQUENCES

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Yield of the Duty

The great productivity of the Excess Profits Duty has been its most remarkable feature. As is shown in the table which follows, Great Britain has collected in five years nearly one billion pounds from this source—approximately one-fourth of her total receipts from both tax and non-tax revenue.

Comparison of Receipts from Excess Profits Duty with Total Revenue[1]

(Fiscal years ending March 31st)

	Receipts from Excess Profits Duty	Total Receipts—Tax and non-Tax Revenue	Percentage furnished by Excess Profits Duty
	£	£	
1915-16	140,000	336,767,000	0.04
1916-17	139,920,000	573,428,000	24.4
1917-18	220,214,000	707,235,000	31.1
1918-19	285,028,000	889,021,000	32.1
1919-20	290,045,000	1,339,571,000	21.6
Total	935,347,000	3,846,022,000	24.3

[1] The data are compiled from the official financial statements. The receipts from the Excess Mineral Rights Duty are not included in the figures given as representing the yield of the Excess Profits Duty. Instead they are merged with the Land Value Duties which are not itemized in the financial statements. Some data regarding the yield of the Excess Mineral Rights Duty are available, however, in the Reports of the Commissioners of Inland Revenue but the figures, being net receipts of the Inland Revenue, are prepared on a different basis from the figures used in the Financial statement. Moreover, because of the delay in printing the reports, the data are not complete. It will be seen, however, from the following items that this part of the Duty was relatively insignificant.

Net Receipts by Inland Revenue from Excess Mineral Rights Duty

(Compiled from reports of Commissioners of Inland Revenue, 1916, p. 67; 1917, p. 5 and 1918, p. 4. Years ending March 31st)

	£
1916.....	3,078
1917.....	152,832
1918.....	262,536

A comparison of the receipts with the budget estimates is of particular interest to American readers as indicative of the degree of accuracy with which the British Treasury is able to forecast the amount of its revenues, even in the case of a new and complicated measure like the Excess Profits Duty.

ESTIMATES AND COLLECTIONS OF EXCESS PROFITS DUTY[1]
(Fiscal years ending March 31st)

	Budget Estimate[2]	Receipts	Receipts, more (+) or less(—) than Budget Estimate
	£	£	£
1915-16	6,000,000	140,000	— 5,860,000
1916-17	86,000,000	139,920,000	+53,920,000
1917-18	200,000,000	220,214,000	+20,214,000
1918-19	300,000,000	285,028,000	—14,972,000
1919-20	300,000,000	290,045,000	— 9,955,000
1920-21	210,000,000[3]		

[1] Data compiled from official financial statements.

[2] In several cases apparently the estimates were revised during the course of the year. In such cases the figures given represent the revised figures.

[3] This estimate, which appears in the Financial Statement, 1920-21, page 6, assumes the 40 per cent rate. Mr. Chamberlain asked for and will probably be given the 60 per cent rate. This would yield, he estimated, £10,000,000 above the £210,000,000 budgeted for 1920-21 and would produce in addition £65,000,000 which would not be paid until 1921-22 and £25,000,000 to be paid the year after, making £100,000,000 additional in all. Speech on making the Financial Statement, April 19, 1920, p. 15. Finally, a full statement should include the outstanding arrears.

In considering the statistics of the yield the British policy of postponing collections must be taken into account. In the summer of 1919 the arrears of the Excess Profits Duty were estimated at no less than £200,000,000.[1] Moreover the bare figures of the collections may be somewhat illusory because concerns subject to the Duty have taken their probable tax liability into account when arriving at prices under government contracts. The figures given do not always represent *net* gain to the Treasury because the existence of the Excess Profits Duty appears to have made it necessary in certain cases for the government to pay more for its supplies than it would, had there been no Duty. The business men speak very confidently on this point and even the Treasury officials

[1] *Cf. supra,* p. 115.

testify that it was probably a factor of some importance during the early years of the war. After 1917, however, conditions were controlled so closely that this element is said to have declined into insignificance.

Evasion and Avoidance

When one comes to deal with consequences other than the direct fiscal effects of the Duty the treatment necessarily becomes somewhat indefinite and unsatisfactory. The various economic results of a tax may be said never to be susceptible of exact quantitative measurement and, in any event, the writer had no opportunity to attempt a comprehensive original study of such effects. All that was practicable was to approach selected persons and to ask them directly what they thought the effects had been. Most of these persons declined to be quoted directly. Some of them had apparently given no serious thought to the problem. Others expressed opinions which were obviously dictated by their interests.[2] On the whole, however, the investigator was impressed by the frankness and the acuteness with which most of the questions were discussed. He believes that in almost every case the opinions given were both intelligent and honest. However, he wishes to emphasize the fact that after all they were merely opinions and that evidence so gathered must be used with great discretion.

The statements ordinarily encountered in England regarding the economic effects of the Duty are similar to those being made in this country. It is freely alleged, particularly by those who desire its repeal, that the tax represses industry, energy, initiative and enterprise; that it encourages wasteful expenditure and recklessness; that it increases prices and the cost of living and that its operation is discriminative and unfair.

Many of the most unfavorable economic consequences result from efforts to escape the burden of the Duty. The question as to how much of the tax is shifted in the form of increased prices

[2] The investigator recalls particularly an interview with a British merchant which was interrupted by the boisterous entrance of one of the stockholders in the concern who joyfully congratulated the managing director on the unparalleled prosperity of the concern as evidenced by the statement just received by him. Much to the embarrassment of the merchant the interruption happened to occur in the midst of an eloquent description of the blasting and depressing effect which the Excess Profits Duty had had upon his own business.

is of significance in this connection but is treated elsewhere.[3] The methods of avoidance and evasion are endless in variety and marvelous in ingenuity. At one extreme stands the device of the prosperous factory owner who declines to exert himself because the taxes upon profits resulting from additional effort leave him too little to tempt him to further activity. He escapes the tax by becoming an industrial slacker but this is a form of avoidance which can scarcely be classified as evasion and it is impossible to prevent or punish it. At the other extreme stands the petty, crude stealing of the small business man who puts his family on his payroll at fat salaries for nominal duties or refrains from recording on his books some of his more profitable transactions.

Between these two extremes lie devices representing every degree of variation in legitimacy and legality. An owner of a rubber plantation postpones tapping his trees until the profits tax shall have disappeared. This results in an undesirable disturbance of the normal course of production yet no action short of declaring the profits tax at present rates a permanent part of the revenue system can prevent the practice. A manufacturer makes low prices to his old customers, hoping to keep their good-will. "Why should I act as tax-collector for the government?" he asks.[4] The factory owner spends his excess profits, otherwise subject to tax, for almost any purpose which, while it can be classified as an expense chargeable to the present year's income, may nevertheless result in increased profits in that future time when profits taxes will be no more, or in an improved goodwill which can ordinarily be sold at any time as a part of the business assets under the English law without the profit becoming subject to income tax or profits duty. This seems to be the cause of the heavy advertising which has been a feature of war-time England.[5] The manager of a large commercial house explained in this way the decision he had made to seize this opportunity for establishing a large number of branch agencies which would for the first few years be losing ventures. If the excess profits duty has depressed those businesses which promise quick returns it has at the same time stimulated other businesses which offer deferred profits.

Renovations and repairs are made on a lavish scale. Greatly

[3] *Cf. infra,* p. 155 *et seq.*

[4] *Cf.* Debates, 74: 368.

[5] Only the shortage of paper limited the expenditure for advertising according to one Treasury official.

increased salaries are paid, especially in the case of those employees who will be likely to remember the employer's generosity and tacitly accept it as advance payment of salary. One foreman chuckled over a half-dozen entirely unexpected and admittedly undeserved bonuses which had fallen into his lap during the last year.

These expenditures for purposes which promise future rather than present returns shade off into mere wasteful extravagance. When the government took £86 out of the £100 of an excess profit (that is, 80 per cent profits duty plus income tax at six shillings in the pound) the tendency was to buy any article selling for £100 which had a value to the taxpayer of £14 or more. Even with the profits tax rate reduced to 40 per cent, the income tax and profits duty take together 58 per cent of the excess profit. Best informed British opinion places the maximum share which can be safely taken by the Government at about 50 per cent. If the government takes more than half of the pound of profit, abuses, it is believed, are certain to develop.

In England when one concern buys out another the pre-war records of the two concerns are amalgamated and form the standard by which to measure the excess profits of the combined businesses. This has led to a lively traffic in bankrupt or near-bankrupt concerns which were prosperous before the war. There is competition for the privilege of using the pre-war records of these now unprofitable businesses.

There has also been a very strong tendency to escape the tax by undervaluing inventories. "In times such as these," observed one business man, "one views his stocks through the wrong end of the telescope." Another merchant cited the case of a business he had recently acquired where the stock valued for tax purposes at £3000 was easily worth nearly double that sum. A large manufacturer testified that materials in the process of manufacture had almost disappeared from the accounts of many plants, such items being easy to manipulate with little danger of detection by the officials of the Inland Revenue.

Everyone agrees that there was comparatively little outright evasion of the Duty during the war. Sentiment then strongly favored the tax and direct evasion was considered a crime little short of treason. Since the armistice, however, an entirely different spirit has been present. The circumvention of the statute has now become a fascinating game at which large numbers ap-

parently try their hand. Whether evasion can be prevented is a question upon which there is the greatest difference of opinion. The Rt. Hon. Reginald McKenna, who, when Chancellor of the Exchequer, introduced the profits tax, remarked that the Inland Revenue had been since 1842 building up an income tax which would prevent evasion and that it would require another hundred years to devise a successful method of administering a profits tax! On the other hand it must be recognized that many of the devices enumerated above are designed to postpone the yield of the business until the profits tax has been abolished. If the tax were made permanent, the efficiency of all such arrangements would disappear. Again, the wastefulness and extravagance in expenditure attributed to the tax is caused by the heaviness of the rates. There is general agreement that from this point of view the 80 per cent rate was a mistake. The prevention of evasion would be a very different problem if the tax were expected to continue indefinitely and at a moderate rate.

Effects upon Business

In 1917, Mr. McKenna, who cannot fairly be charged with being a violent partisan of the Duty, made the following statement in the House of Commons:

"I, for one, would never have anticipated that a revenue of this magnitude would have flowed into the national coffers without apparently the slightest injury to our trade or business credit or commerce."[6] Mr. McKenna is able today to point out injurious effects which have become apparent since his speech, but it is indeed remarkable that the injury and disturbance has apparently been so slight. It must be borne in mind, of course, that the entire situation is a highly abnormal one and affords no true guide as to what effects may be expected from the operation of a heavy profits tax under the ordinary competitive conditions of peace.

Effect upon Business Stability.—The collection of the Excess Profits Duty has been accomplished without acute distress to the taxpayers. Few have found it necessary to borrow from the banks to meet the payments. The Treasury officials insist that no concern has been seriously embarrassed. There are several reasons for this, the most immediate being the Treasury policy of postponing collections whenever there appeared to be ade-

[6] Debates, 93: 398.

quate ground for so doing. Then, also, the trading has, of course, been done predominately on a rising market.

However, from the fact that there have been no failures directly traceable to the Duty it may not be fairly inferred that the strength of the business concerns has not been impaired through the collection of these huge sums.[7] Reserves which might otherwise have been accumulated are non-existent. It has been difficult for business men to increase their capital investment at the very time when increased capital was necessary to the continuation of their business on even the same scale as before. One manufacturer stated that at that particular time of year he would ordinarily be manufacturing for stock, but that the high prices of materials and the necessity of meeting Excess Profits Duty payments made it impossible for him to do so. But here one may not generalize. Many British corporations ordinarily pay out profits in dividends very closely and do not build up capital through reinvestment of current earnings. The writer was told by a merchant intimately associated with the textile trade that there had been no weakening of reserves in that industry but that, on the contrary, most of the concerns were coming out of the war with stronger financial resources than they had ever had before. Representatives of certain other lines of manufacturing, on the other hand, testified that, while there might be no obvious evidences of weakness, the real test still lay ahead and that many concerns would find themselves seriously compromised should they encounter a period of falling prices. Last year's Duty is often paid from this year's earnings, the profits which formed the basis for the assessment having been promptly "ploughed into the business" in the form of plant extensions or inventories valued at high prices. However, the provisions already made or contemplated by the Government for preventing hardship from losses due to inventory shrinkages[8] will undoubtedly tend to alleviate the dangers in this situation. Obviously it is one which holds sinister possibilities in a period of depression.

Whether the effects of the Duty on business stability are more or less serious than would have been the effects of some alternative tax producing the same revenue is an open question.

Repressive Effects.—The tendencies described in the preceding section may, of course, have serious repressive and restrictive

[7] *Cf.* Debates, 81: 1078.

[8] *Cf. supra,* p. 57 *et seq.*

effects even though they do not result in serious instability or positive business failures. It is the universal testimony of business men in England that the tax has been a real burden. Not only has it depleted the funds which otherwise would have been available for expansion and development but, through the constant threat of appropriation of possible future profits it has discouraged the initiation of many new enterprises.

The point last stated was especially stressed by a large steel manufacturer. He stated quite frankly that the existence of the Duty had been a prominent influence in preventing the full resumption of business in his own plants. He did not intend to "get down to business," he declared, until he could secure some definite idea as to what was going to happen to future values because under the present arrangements he would have to take risks entirely out of proportion to the profits he would be permitted to retain even if very successful.

It is obvious that to take from an enterpriser the fruits of his efforts will tend to discourage his activities. The Excess Profits Duty, especially at the 80 per cent rate and coupled with high income taxation, took a very large share of those fruits. When there is added to this situation the possibility of early repeal or substantial modification, the repressive effect for the immediate present is materially heightened. The British business men allege that their Duty tends to sanctify the traditional profits of well-established concerns, rendering them immune from competition, and that it tends to discriminate against young and growing businesses. They claim that it places a penalty on aggressiveness and ability and a bounty on conservatism.

Such arguments must be considered in connection with all of the factors in the situation. A tax which singles out the more able for a special contribution does not do violence to accepted conceptions of fiscal equity. Moreover, the repression argument is often used somewhat inconsistently by those who insist that the tax is shifted in the form of higher prices. Again there is some evidence that the net effect of the tax in some cases is distortion rather than repression as, for example, when swollen expenditures, deducted as current expenses, are designed to ripen into income at some future time after the Duty has disappeared. Whatever stimulation results from such distorted investment must be offset against the repressive tendency. Finally, sound conclusions can be reached only by taking fiscal necessities into account. The

ill effects of the Duty in the direction of repression must be contrasted not with a situation where no substitute tax is imposed but rather with a situation as it may be assumed to exist with other taxation in force sufficient to yield the same revenue. Thus if the profits tax is actually borne by the business and not shifted in increased prices the business man may offer his wares to a community whose purchasing power is unimpaired. If the sum now raised by the profits tax were placed directly on articles of consumption in the form of commodity taxes it is conceivable that this method of raising the money might prove to be repressive, perhaps even more so than the profits tax, because of diminished purchasing power and disturbed conditions resulting therefrom.

In general it is clear that the effect of the Duty in Great Britain has been repressive but it is not evident that it has been more restrictive or repressive than any available alternative would have been. The writer found only one business man, among the dozens questioned on the point, who professed to believe that the Duty was more repressive than a capital levy, the substitute most actively advanced.

Discrimination.—One of the most telling criticisms urged against our Excess Profits Tax is that it operates in a capricious and unequal manner, taxing heavily businesses which should be encouraged while laying a light hand upon others which should pay heavy tribute under such a law. The blame for the discrimination in this country rests partly upon our statute and partly upon our administration.

The writer found no one in England who intimated that there had been any discrimination in the administration of the Duty. All agreed that even-handed justice had been given as between business and business so far as it was administratively possible to achieve it. Many of the persons interviewed, however, were very emphatic in their assertions that a profits tax with a pre-war profits standard inevitably worked injustice in the application of its fundamental principle. The general assumption that all increased profits over and above the pre-war level are excessive is, they insist, both crude and contrary to fact. Even with the safeguard of the alternative "percentage standard," the young, progressive business which during the pre-war period was just "getting on its feet" is often at a disadvantage. Accident or chance in the early history of a business sometimes has a profound effect upon the amount of the Duty payable. One manufacturer con-

gratulated himself upon the fact that his concern had inaugurated the practice of paying heavy directors' salaries just before the outbreak of the war but late enough to enable him to select a very favorable pre-war profits standard by going back to still earlier years under the six-year option.

In discussing the discriminatory effects of the Duty, Bonar Law made this statement in the House of Commons in 1917:

"It does tell very unfairly and it is inevitable that it should. . . . . It tells unfairly against one trade as against another trade. In many cases it tells against particular methods of carrying on trade as against other methods of carrying on the same trade. I recognize all that."[9]

An inspection of the various relief provisions will make it clear that the administration in Great Britain can go much further than is possible under our statute to eliminate discriminations. The situation in this respect is undoubtedly very much better than that which exists here but the fact remains that in spite of better administration and the greater elasticity of the statute, considerable complaint is made in England regarding the inequity of the tax as between two businesses of substantially the same economic strength.

Effect on Business Morale.—Business men freely assert that the Excess Profits Duty has encouraged high costs of production. The fact that after a certain point is reached additional expenditures cost the concern little has been capitalized by labor leaders in arguing for increased wages[10] and has been used as an excuse by managers for laxity and ineffective control of expenses. Mr. Stanley Baldwin, Lord Commissioner of the Treasury, commented on this situation as follows before a deputation of the Association of Chambers of Commerce.

"I think that point that Sir Algernon put about the result of the Excess Profits Tax on the *morale* of business, is a very genuine one indeed. I do think the tendency of the Excess Profits Tax in this country, especially as the amount rises, is to take away a certain amount of initiative, which is very bad for business. It also encourages carelessness in management. I was very much struck by what you said, Sir Algernon, because it is within my experience that there comes an idea amongst masters and men that it does not matter what you pay in wages or in management

[9] Debates, 93: 384.

[10] Association of Chambers of Commerce, Deputation of April 24, 1917, p. 7.

expenses, because it has all to come out of the Government and so what does it matter?"[11]

It is interesting to note that these lowered standards in management are pointed out as one of the effects of the Duty which is most likely to prove embarrassing in the post-war competition with this country.

Miscellaneous Effects.—In addition to the more important business effects noted above, various incidental effects are ascribed to the Duty. The labor leaders give the Duty considerable credit for the growth of "welfare work" in British industrial plants and for the improvement in industrial housing. Expenditures for such purposes were ordinarily deductible as expenses which virtually amounted to Government payment so long as the Munitions Levy was in force and even under the Excess Profits Duty so long as the rate was 80 per cent.

Another indirect and incidental effect has been the influence of the Duty upon British business policy with regard to the scrapping of plant. The liberal deductions permitted during the war for obsolescence stimulated the practice of scrapping machinery which had become worn or out-of-date. The reluctance of the British to discard such machinery has been often pointed out as one of their competitive short-comings so that the influence of the Duty in this direction is considered salutary by their best business men.[12]

Effects upon Prices

Precisely what effects the Duty has had upon prices it is impossible to say. Some conception of the diversity of the testimony may be gathered from the following opinions of representative Englishmen:

A merchant: "The Duty has had only a slight effect upon prices."

A merchant: "There has been little effect upon prices in the merchandizing lines."

A bank president: "The tax has had no effect at all on prices. It is a sellers' market and under present conditions the sellers would charge just as much if there were no tax."

A banker: "The Duty has had an enormous effect upon prices. Business men have come to allow for it and have passed it on to the consumer."

[11] *Ibid.*, p. 15.

[12] *Cf.* Bonar Law's opinion. Debates, 93:383.

A financial editor: "Under the abnormal conditions which have been present there has probably been some effect upon prices. I cannot see, however, how such a cause can affect prices in general."

A steel manufacturer: "In normal times I should expect little effect or none at all. In times of controlled industry and undersupply, however, it has probably been of great importance."

A textile manufacturer: "In the textile trade the tax has been used as a pretext and excuse for profiteering. Prices would have been as high without it."

A glove manufacturer: "There is no question but that the Duty has had a great effect upon prices especially in controlled establishments."

An economist: "The Duty increased the cost of munitions manufactured in Controlled Establishments. It was only in such establishments, however, or in other situations where competition was absent that the Duty could have been responsible for increased prices."

An economist: "Of course a profits tax cannot increase competitive prices."

A public official: "The tax has had a very profound effect on prices. Every business man down the line—manufacturer, wholesaler and retailer—has added it on and passed it along. The charge has been cumulative under the conditions of control and restricted supply which have obtained."

An accountant: "It has had a serious effect. Business conditions have been abnormal. Business men have been able to dictate their own prices and they have felt that they must get profits after paying taxes fully as great as they formerly received."

The English newspapers are full of complaints placing upon the tax a large part of the responsibility for the prevailing high prices. Sidney Webb asserts that such statements, so far as they refer to commodities not under government control, spring from "sheer ignorance" and most of the economists agree with him. Business men, however, almost universally testify that the tax has influenced them to increase their prices. They claim that by a curious inversion the tax, designed in part as a corrective of excess profits, becomes itself a cause of excess profits. But in some of these cases one suspects that the tax has been seized upon as an excuse for monopoly prices which would be just as high in the absence of the Levy and that the argument represents at once an apology for past greed and a plea for future exemption from just burdens. One manufacturer told the investigator that his concern, suddenly finding itself after a number of lean years in possession of a large stock and confronted with a demand so great that it could not possibly meet it, was in a position where it could ask almost any price it chose for its product, and the fact that

the profits duty had to be paid influenced his directors to charge a higher price than they otherwise would have asked. Such tender-hearted tyros at profiteering who depend on the tax to give them moral courage to charge what they can get for their goods in the market are probably rare economic phenomena and, moreover, unless they happen to be selling directly to the consumer anything they refrain from adding to their price is probably added to it by the next man in the marketing chain, so that the ultimate retail price is no lower.

On the other hand, another manufacturer testified that he had deliberately reduced his prices to avoid the tax, expecting by offering his goods at very reasonable rates to build up a good-will which would yield added returns later when the profits tax had disappeared.

It is not easy to understand how a tax which is imposed only after moderate profits have been accumulated can operate in an important and direct fashion as a cause of high prices, if the market is freely competitive. Even in a seller's market such as exists in many lines today, the power to charge a high price is not dependent upon the existence of such a tax. There probably are long-time, indirect effects in the direction of increased prices from a business tax such as this. If the Duty does encourage laxity in management, there would be a reflection in prices. The slightest repression on enterprise—and this tax undoubtedly does exercise some repression in the long run—would be expected to have such effects.

There is general agreement in England that in the case of commodities manufactured under government contract, especially during the earlier years of the war, the Excess Profits Duty was very often taken into account in arriving at a price. That is, the manufacturer usually considered the excess profits duty an expense and succeeded in securing terms which left him after paying it about the amount of profit he would have striven for had the tax not been in existence. Consequently the tax in England was probably to a considerable extent illusory, the government itself creating the profits which it took back in taxes.

Summary

(1) In the past five years the British Treasury has received approximately one-fourth of its total revenues from the tax on excess

profits—nearly one billion pounds in all. This enormous sum has been collected with surprisingly slight economic disturbance.

(2) During the war outright evasion was almost unknown but since the armistice many taxpayers have resorted to various methods of avoidance and evasion.

(3) The collection of the Duty has caused no business failures and has apparently not seriously undermined the stability of the business structure generally. There is no doubt, however, but that its general effect upon business has been restrictive and repressing. Whether its effect has been more unfavorable than the effects of some alternative tax is doubtful.

(4) Even with a more elastic statute and more efficient administration, it has proven impossible to avoid entirely the criticism that the Duty operates in certain cases in a capricious and discriminating fashion.

(5) It is freely asserted that the Duty has been an important influence making for high prices but the best-informed opinion appears to hold that the tax has been in most cases the excuse for and not the true cause of the increases in prices.

PART FOUR

FUTURE OF SPECIAL PROFITS TAXATION IN GREAT BRITAIN

PART FOUR

FUTURE OF SPECIAL PROFITS TAXATION IN GREAT BRITAIN

American interest in British plans for the future of special profits taxation in their country springs primarily from a desire to reach a wise solution of our own problem. Since general conditions in the two countries are fundamentally similar, it is but natural that British precedents should have great weight with us in arriving at decisions in the field of public finance. But, in addition, the American business man engaged in foreign trade has, of course, a special interest in the British practices and plans. While it is probable that the effects of special profits taxation upon the international competitive situation are greatly exaggerated, the trader, nevertheless, always displays a keen interest in the taxes which his competitors are called upon to pay. Finally even those business men who are not even remotely affected by British competition are interested. When they pay their heavy profits taxes here, they may derive some consolation from the knowledge that their British brothers continue to be subject to similar exactions.

The British Finance Act of 1920, recently adopted, continues the application of the Excess Profits Duty until August 5, 1921.[1] Not only does it continue the Duty when most British business men expected its entire abolition but it increases the rate from 40 per cent to 60 per cent. The circumstances which led up to this action and the outlook for further developments receive consideration in this section of the report.

The present British Excess Profits Duty was obviously designed as a temporary measure which would disappear at the end of the war. The use of pre-war profits as a datum-line is in itself sufficient to establish its temporary character. But to this internal evidence may be added the specific declarations of every Chancellor of the Exchequer who has held office since the introduction of the Duty.[2] The business men have accepted these declarations as virtual pledges and vehemently denounce the policy of continuing

[1] *Cf. infra,* p. 212.

[2] Debates, 81: 1044; 93: 390; 1920 budget speech, p. 15; Association of Chambers of Commerce, 1918, p. 20; 1919, p. 158.

the Duty.[3] Immediately after the close of the war pressure was brought to bear upon the Government to secure the entire abolition of the Duty. During the preparation of the 1919 budget the question was carefully considered but it proved impossible to forego the revenue. The Treasury, consequently, turned its attention to the problem of changing the Excess Profits Duty into some new form of excess profits tax which would be free from the anomalies incident to its application to the profits of years far remote from the pre-war period. This early project to establish a permanent excess profits tax appears to have been carried far along toward fruition before it was discarded for the moment and, as appears from the following section of Mr. Chamberlain's speech, delivered April 30, 1919, the project was merely postponed and not definitely abandoned:

" . . . I turn now to direct taxation, and, first of all, I must say something about the Excess Profits Duty. The tax in its present form is a war tax. It was imposed under the stress of war, and when, in the midst of the enormous burdens we had to bear, it was felt that profits in excess of pre-war profits might justly be called upon to make a special contribution. It is open to many objections, but it was a rough and ready method of justice which Parliament, in its then, happily, not very critical mood, accepted without too much difficulty, and the revenue results of it have been most satisfactory during the War period. . . . I do not wish to continue the tax a moment beyond what is necessary at so high a figure as at present; it would be contrary to public interest, and I do not propose to do it. On the other hand, I have to remember that, as I said, this is a war tax, that war expenditure is still continuing, that even after peace is signed war expenditure and the burdens of war will still remain, and *I am not in a position simply to repeal the Duty without finding anything to put in its place.*[4]

"In these circumstances my first effort was to find some form in which the profits of business might be called upon to make a special contribution to the revenue of the country without the anomalies and the objections to which the present tax is subject. I had before me suggestions made to that effect by my hon. Friend the Member for the Everton Division of Liverpool (Sir

[3] *Cf., Pall Mall Gazette,* April 20, 1920.

[4] The italics are the writer's.

J. Harmood-Banner) and by Mr. J. F. Mason, who was then a Member of the House, and who I very much regret is not now a Member, and by Mr. Lionel Hichens, a name well known in industry,[5] and I had also the example of taxation imposed with similar objects both in the United States and in Canada. But my information is imperfect, and the time at the disposal of myself and my colleagues has been short, and we have been subject, as the Committee knows, to other daily grave preoccupations. I need not say that if a new tax is to be imposed, it would in any case be necessary that it should be carefully thought out and its advantages and disadvantages carefully weighed in order that we should not repeat the anomalies or injustices of the existing tax. Therefore the form of the tax would be of great importance, and such an enquiry takes time. I have had other suggestions made to me, but the Government have not been able to give to the subject in the weeks before the Budget the attention which it requires for a satisfactory solution.

"Under the circumstances, therefore, I propose to the Committee, as a temporary and only as a temporary measure, to continue the existing tax for another year at the reduced rate of 40 per cent."[6]

It is evident from Mr. Chamberlain's speech that there was hope in his mind that he would be able in 1920 to substitute for the

[5] The proposals for the continuance of profits taxation made by several individuals, to which the Chancellor referred in the speech just quoted were these. Sir John Harmood-Banner in an article in the *Sunday Times* of November 10th, 1918, had urged the early abandonment of the present tax with its pre-war standard, but had favoured a profits tax in some other form. His proposal was discussed incidentally on the floor of the House of Commons about a week later. (Debates, 18th November, 1918, 3182-3.) Some months earlier, Mr. Mason had urged in the House that a profits tax be devised which would be coupled with a policy of government protection and assistance to British industry and would depend for its theoretical justification upon this aid thus extended. (April 22, 1918, Debates, 105: 781). Finally, in a lecture given in January, 1918, Mr. W. L. Hitchens, Chairman and Managing Director of Messrs. Cammell Laird & Co., Ltd., and prominent in the Association of the Controlled Establishments, had proposed a post-war tax on profits similar in general character to the War Profits Duty. He rested his case on the general ground of the moral and economic injustice of unlimited profits. ("A Moral Code in Industry." *Times,* January 19, 1918.)

[6] House of Commons—Session 1919. Report of the speech of the Rt. Hon. A. Chamberlain on making the Financial Statement, Wednesday, 30th April, 1919, separate print, pp. 16-17.

Excess Profits Duty some new type of permanent excess profits tax. At the time of the writer's visit to London in the summer of 1919, he found that most business men expected the early abandonment of the Excess Profits Duty but that they were giving almost no thought to the question of a substitute. Persons who were fully informed regarding the fiscal exigencies of the situation realized the necessity for such a substitute and were much occupied with the problem. The two possibilities most seriously discussed were the capital levy and the new profits tax suggested in Mr. Chamberlain's speech, quoted above. With the capital-levy proposals, interesting and ingenious though they were, this study is not directly concerned. Suffice it to say that they were so repugnant to the preconceived notions of the business men that their adoption seemed most improbable.

The proposal for a permanent profits tax had by this time assumed fairly definite form and was the plan which appeared to hold most promise of adoption. It is of interest to Americans to know that the best British opinion appeared to favor a tax of the general type of our own excess profits tax with its standard of invested capital and its progressive scale of rates. The British proposal met a number of the difficult problems connected with profits taxation in a manner which is in some instances suggestive. For example, they could see no justice in making the tax apply to corporations only as is the case under our present law. Again, they felt that the problem of business concerns with little or no invested capital could be fairly well met by utilizing a sliding scale of salary allowances instead of exempting them as we do. The distinction between a profession and a business is one which troubled them sorely, but nevertheless they considered it possible to establish the differentiation in a fashion similar to that used under the Excess Profits Duty. The fact that appreciations of property values are not considered taxable income in England raised a problem for them which has not troubled us seriously here. If they were to recognize as invested capital the full amount paid for assets, tangible and intangible, by the purchaser of a business, they realized that their new tax would be widely evaded unless it were coupled with some type of special increment tax upon the profit from the sale, imposed at the time of transfer. The difficulties of arranging such a tax, which in our case are cared for automatically in a fairly satisfactory manner under our income tax, led them to favor the adoption of the rule that assets should

be valued at cost to the original owner even after having been transferred to the new purchaser.

In the fall of 1919 Mr. Chamberlain dispatched a mission to America to study the profits taxes of this country and Canada[7] so that he was able to enter upon the preparation of the 1920 budget much more fully equipped with information with regard to excess profits taxes with invested capital standards than he had been a year before. The new data appears not to have been wholly reassuring but what was even more important was the violent reaction among the business men. The mere suggestion that the profits tax might be placed on a permanent basis raised a storm of protest and the proposal did not survive long enough to be presented to Parliament in the Chancellor's 1920 budget speech. The situation as it now exists is best presented in Mr. Chamberlain's own words:

I come now to the Excess Profits Duty. I attempted last year to state fairly the arguments for and against the Excess Profits Duty when I asked the Committee to continue it for another year at a reduced rate of 40 per cent. But there was one factor in the situation which I have to confess I entirely failed to forecast. If hon. Members will cast their minds back to the circumstances in which I spoke last year, I do not think they will blame me or pretend to greater prescience. Industry was then disorganised, unemployment was rife, and there was every prospect of declining prices and a great fall in profits. But the results have been far otherwise. There has been no such decline; on the contrary, manufacturers are overwhelmed with orders in excess of what they can execute. Prices have risen and the level of profits has still further increased. Had I foreseen this situation there would have been no such large reduction in the duty last year, and the Committee will not be surprised to learn that in view of it, and subject to one condition, which I will explain, we propose not only to continue the duty for another year, but to increase it as from 1st January last, not indeed to the 80 per cent. rate at which it was in force in 1917 and 1918, but to the 60 per cent. at which it was fixed in 1916. I base my justification for that proposal on the continued prevalence of temporary conditions occasioned by the War or arising out of the War, creating a state of scarcity, hardly distinguishable in effect from monopoly, and giving capital engaged in industry wholly abnormal and often extravagant profits. I propose to increase the rate subject to one qualification. The qualification is this. As the Committee is aware, a Select Committee of this House is now enquiring into the practicability of a levy on War increases of wealth. If, when they have completed their deliberations, the Committee make

[7] Unfortunately the report of this commission has not been made public.

recommendations to the House, and if Parliament should decide later in the year to impose such a levy, the funds thus made available will relieve the pressure of the financial situation and enable us to reverse the decision to increase the rate of Excess Profits Duty to 60 per cent. I shall propose, therefore, if it falls to my lot to submit to Parliament a Bill later in the year to make a levy on the increases of war wealth, to cancel this increase of the rate of Excess Profits Duty, and collect Excess Profits Duty for the year at the existing rate of 40 per cent. The increased revenue that will be derived from this source in the current year, on the assumption that the rate is 60 per cent., will be only £10,000,000, raising the estimate of the total revenue from this source from £210,000,000 to £220,000,000. As I have already reminded the Committee, the main effect of any change in the rate of Excess Profits Duty is felt in the year following the change, and more important than the additional £10,000,000 in cash this year will be the further sum amounting to £65,000,000 accruing but not collected during the present year, and a still further sum of £25,000,000 receivable the year after. In other words, the addition to the Tax will produce £100,000,000 in all. This increase will involve a corresponding increase in the rate of Excess Mineral Rights Duty, a Duty which is complementary to the Excess Profits Duty.

But whilst I consider that these proposals are not merely justified but are required by the abnormal conditions now prevailing, I also hold that this tax itself, like those conditions, is, or should be, abnormal and temporary in its character. I propose therefore to introduce this year a new tax which, for the time being, will be levied concurrently with the Excess Profits Duty, but which, either in the form in which I propose it or in an amended form, may in the future prove a substitute for it. The character of the new tax, a permanent tax, has been the subject of most anxious consideration by the Government and myself and, as I have previously mentioned in the House, last year I sent out a mission to Canada and the United States to investigate and to study the schemes of Profits Taxation in force in those countries, and to see whether we could derive any lessons of use to us from their practice and experience. The results of the inquiry and of independent investigation in this country have not served to remove the difficulties which presented themselves on our first consideration of the proposal for a taxation of profits in excess of a certain return upon invested capital, and have not enabled us to see our way to adjust such a tax to existing business conditions and customs in this country. We, therefore, abandoned the idea of creating a tax on profits in excess of a fixed standard and we propose to have recourse to a different measure. I may describe our proposal as a Corporation Tax levied at the rate of 1s. in the £ on the profits and income of concerns with limited liability, engaged in trade or similar transactions. This tax will run concurrently with Excess Profits Duty until that Duty is repealed. Where a concern is liable to both taxes, any Excess Profits Duty payable will be treated as a working expense in arriving at the

profits for the purpose of the new tax. Both Excess Profits Duty and Corporation Tax will be deducted before the assessment of profits for Income Tax, and to prevent the new tax constituting too severe a burden on the ordinary shareholder of existing concerns in which there are large issues of debenture and preference shares, where a considerable proportion of the profit has to be allocated to the payment of interest and fixed dividends thereon, we propose that in no case shall the duty exceed 2s. in the £ on the profits which remain after the payment of such interest and dividends on existing issues of debentures and preference shares. I would remind the Committee that under the provisions of the Excess Profits Duty prosperous concerns with a large pre-War profit standard may escape liability for the tax because their present profits, though high, are not in excess of their standard, and, at any rate, they pay tax on what all of us think an unduly low scale. Incidentally, the new tax will do something to correct this anomaly. But I justify it on much broader grounds. Companies incorporated with a limited liability enjoy privileges and conveniences by virtue of the law for which they may well be asked to pay some acknowledgement. But more than that, partners in a private partnership pay Super-tax not merely on the profits which they divide, but also on the undivided profits which they place to reserve. No such charge falls upon the undivided profits of limited liability companies. The Corporations Tax is justified by this distinction of the existing law in favour of such corporations, and it may be regarded as a composition in lieu of the liability to Super-tax. How soon it may be possible to discontinue the Excess Profits Duty and to rely upon this new tax alone must depend on many circumstances, upon the duration of the abnormal conditions and abnormal prices and profits which we now witness, but, most of all, on the results of the inquiry which the Select Committee on War Wealth is now conducting upstairs. I estimate, on the basis of existing prices and rate of profits and assuming the continued development of industry, the yield of the new tax by itself should in a full year amount to £50,000,000 and, while levied as an addition to Excess Profits Duty at the rate of 60 per cent., will in a full year produce £35,000,000. The largest part of the tax levied and accruing this year will not reach the Exchequer till next year, and for this reason I do not anticipate that the sum obtained in the current year will be more than £3,000,000.[8]

It is clear that the proposal for a permanent, progressive excess profits tax with an invested capital standard has been definitely discarded for the present at least. The new corporate profits tax appears to have been the fruit of the researches of Mr. Chamberlain's mission to America. Its principle is quite novel in England and what development lies ahead of it cannot be fore-

[8] Speech on Making the Financial Statement, Monday, 19th April, 1920, pp. 14-16.

told. Since the budget speech the Government has abandoned the project for a levy on capital and Mr. Chamberlain's alternative proposal of a 60 per cent Excess Profits Duty for the year 1920 has been adopted.

The ostensible reason for discarding the proposal for a permanent excess profits tax is the reluctance on the part of both the business community and the Inland Revenue to attempt a general evaluation of business capital. This is, of course, a task whose difficulties may well give pause. However it is also true that the business leaders are opposed to a permanent excess profits tax on principle. It appears to them discriminatory and dangerous—discriminatory because the validity of the general principle of special business taxation is not acknowledged in England and dangerous because the admission of the principle would open the door to a permanent policy of social control of profits. The socialists are not the least interested in the Excess Profits Duty at present but the most acute of the business men profess to see in it a potent socialistic weapon. A Labor Government within a reasonably short time is not beyond the range of possibility and the business interests are very eager that such a government may not find in good working order a special profits tax established on a permanent basis. They are willing to make temporary sacrifices in the way of submitting to uneven taxation as between individual businesses provided only they can maintain the present status of the Duty as a temporary measure.

The situation may be briefly summarized as follows: In the summer of 1919 the general expectation in England was that the Excess Profits Duty would disappear with the expiration of the financial year. This view was not shared, however, by those who were fully informed regarding the status of government finances. Such persons pointed out that the Duty could be repealed only in case some productive substitute could be found and, placing little faith in the proposal for a levy on capital, they directed their thought to the possibility of developing some new type of special profits tax which could be established in the place of the Excess Profits Duty. At the time of the writer's visit the proposal which appeared to hold most promise of being enacted into law was one providing for an excess profits tax very similar to the one now in force in this country, levied at progressive rates upon profits whose richness was determined by reference to a standard of invested capital. During the winter of 1919-20 the problem was

warmly debated, the discussion being characterized, first, by the development of bitter opposition to any new special profits tax which would bear the stamp of permanency and, second, by the growth of a surprisingly strong sentiment in favor of some modified form of capital levy. When the budget was finally established it included neither proposal. Instead of a capital levy or a new permanent excess profits tax the British have chosen to continue the old Excess Profits Duty at the increased rate of 60 per cent and to establish a new flat five per cent tax on the profits of corporations. The British policy with respect to the future is not fixed but special profits taxation in some form will probably constitute a part of the financial plan for several years to come.

CONCLUSIONS

CONCLUSIONS

A comprehensive survey of the material presented in this report can be quickly made by reading the brief summaries which appear at the end of each of the four main divisions.[1] In conclusion, consequently, it remains only to point out the significance of the British experiences to us, as we face the problem of the future of the tax in America.

The scope of this report does not permit an analysis of the American financial situation, and without such an analysis it would be quite improper to venture a definite statement as to whether we should repeal the excess profits tax or continue it. However, this much can be said most emphatically: If we can afford to make the rates moderate and if we have the wit to follow the British precedents as set forth above, we can remove the ground for the most serious criticisms now being urged against our excess profits tax. The grounds for criticism which will remain may still be sufficient to render the tax unattractive as compared with available alternatives. If so, the tax should be abandoned. But, at a time when our fiscal necessities are so great, the possibility of recasting the tax in the light of British experience must be taken into account in arriving at a wise decision. Certainly nothing is revealed which gives cause for great alarm or forms ground for a demand for the hasty repeal of our tax. On the contrary, the British have shown us that it is possible to introduce sufficient flexibility into the administration of a profits tax to enable it to conform fairly satisfactorily to the complex conditions of modern business. They have also shown us how to eliminate the friction which arises when important questions of judgment are left entirely to bureaucratic officials. The solution they offer us involves a radical improvement in our administrative organization and procedure, but students of federal taxation are beginning to believe that such changes must come anyway, and come quickly if we are to save the federal income tax itself from disintegration. The solution offered also involves the establishment of a system of appeals based upon a principle entirely novel in our treasury organization, *viz.*, that of arbitration before juries of disinterested outsiders. This principle has always formed a part of the British income-tax procedure, and has thoroughly justified itself in the

[1] *Supra,* pp. 23, 137, 157, 165.

elaborated form which was established for purposes of the Excess Profits Duty. We should lose no time in appropriating this device whether we continue or abandon the profits tax.

If we are to continue profits taxation, the general standard prescribed in our present law for determining the richness of the profits should be retained. The best British opinion supports the view that a percentage of invested capital is a more satisfactory test than the earnings of some previous period, in a tax of this character, and they have shown how that percentage can be cleverly varied to meet the peculiar conditions in each line of business.

With respect to the British decision this year to continue their profits tax without eliminating their "profits standard," two points should be made clear. The first is that their tax is not now and never has been entirely dependent on the profits standard. In fact, the testing of profits by the standard of earnings in the pre-war period really operates as a relief provision, reducing the tax which would be payable if the percentage standard only was utilized. With the passage of time the percentage standard, based on invested capital, has been assuming a larger and larger rôle in the procedure. The second point to be borne in mind is that in the deliberations this year regarding the advisability of establishing a permanent profits tax, the issue really turned on a quite different consideration from that of the relative merits of the invested capital standard as compared with the present alternative standard. The writer is convinced from his conversations with the British business men that it was not so much the invested capital standard which aroused their opposition as it was the fear of permanency in a profits tax. So long as the present tax with its pre-war standard remains, there exists a *prima facie* case for its repeal in the more or less immediate future. But, with a Labor Government threatening in the offing, the business men prefer not to face the future with a profits tax firmly established on a basis which can be made permanent by a mere continuance of established policy and practice. Thus much larger issues are involved in the matter than appear on the surface. In this country, with its different social and political conditions, this aspect of the problem has received almost no consideration, but the fact remains that in the principle of special profits taxation there may exist a practicable method of arriving at a solution of the problem of monopoly profits against which the American public has stead-

fastly set its face, and of seizing some of the promised advantages of socialized industry without incurring the risks and disadvantages of socialism.

Several very serious defects in our own national financial situation are brought into bold relief by a study of the British Excess Profits Duty. The first is that we have not grasped the fundamental importance of adequate preliminary consideration of tax measures. The British seem to be able to choose a course and hold to it consistently. It was only about one year after the war began that they established their Excess Profits Duty, but even at that early date it was established in a form which they have found unnecessary to change in any important particular. Today they have essentially the same scope of application, the same definition of profits, the same standard of excessiveness, the same rules for calculating invested capital, and the same general procedure as they had at the beginning. We began with a law of broad application and then swung to the opposite extreme of very narrow application. We began with an invested capital standard, the next year we substituted an alternative standard, and the third year reverted to the first type once more. We have tinkered with the definition of profits and made important changes in procedure. The British contented themselves with mere changes in rates to meet varying fiscal needs. Our constant changes have had many unfortunate effects, perhaps the most serious being the tendency to unstabilize business and to complicate the administration. It does not reflect credit upon us that we, in 1917, could not draft an act suited to our situation, whereas Great Britain was able in 1915 to pass a law which has required practically no revision since.

A second weakness is our comparatively narrow conception of the accounting period. If we are wise, we will copy the British practice with respect to this. The problem is as significant for income taxation as for profits taxation and is one which will be particularly important in the period of falling prices upon which, apparently, we are now entering. In effect, we decline to regard business as a continuing operation. We separate the history of a concern into arbitrary periods and carefully insulate each period from every other period. This procedure is not in accord with the economic facts. We should frankly recognize net loss whenever it occurs and make whatever readjustments are necessary to equalize the total burden as between taxpayers, not merely on the

basis of each year, but for the operations on a long-time basis. Such a recognition of losses would eliminate much of the injustice of the present situation.

A final important shortcoming, which becomes apparent from a study of the British situation, is our under-appraisal of the administrative factor. We are on the whole not slow to grasp the significance of underlying principles, or to appreciate the theoretical niceties and refinements of these complicated tax measures, but we appear to be willing to ignore the existence of many of the administrative problems upon whose solution the success of these measures depends. We should cultivate the British reluctance to pass a tax measure until assured of the adequacy of the Treasury staff to undertake the task. We should see to it that our administration is made adequate to the demands even now laid upon it. Administration, after all, holds the final veto on any tax proposal and a failure to recognize this fact is almost certain to result disastrously. The plain truth of the matter is that unless we abandon our amateurish and naïve attitude and face this problem of administration frankly, we shall have to content ourselves with a tax system which will attain simplicity at a very high cost in terms of equity. We cannot have just taxation under the complicated conditions of modern economic life unless we prove ourselves equal to the task of establishing a skilled and permanent civil service.

APPENDICES

APPENDICES

APPENDIX A

TEXT OF STATUTES RELATING TO EXCESS PROFITS DUTY

I. Munitions of War Act, 1915

(5 & 6 George 5, Ch. 54, 2nd July 1915)

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Part II

4. *Controlled establishments.*—If the Minister of Munitions considers it expedient for the purpose of the successful prosecution of the war that any establishment in which munitions work is carried on should be subject to the special provisions as to limitation of employers' profits and control of persons employed and other matters contained in this section, he may make an order declaring that establishment to be a controlled establishment, and on such order being made the following provisions shall apply thereto: —

(1) Any excess of the net profits of the controlled establishment over the amount divisible under this Act, as ascertained in accordance with the provisions of this Act, shall be paid into the Exchequer.

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Where in any establishment munitions work is carried on in some part of the establishment but not in other parts, the Minister of Munitions may, if he considers that it is practicable to do so, treat any part of the establishment in which munitions work is not carried on as a separate establishment, and the provisions of this Act shall take effect accordingly.[1]

5. *Supplementary provisions as to the limitation of the profits of a controlled establishment.*—(1) The net profits of a controlled establishment shall be ascertained in accordance with the provisions of this section and rules made thereunder and the amount of profits divisible under this Act shall be taken to be an amount exceeding by one-fifth the standard amount of profits.

(2) The standard amount of profits for any period shall be taken to be the average of the amount of the net profits for the two financial years of the establishment completed next before the outbreak of the war or a proportionate part thereof.

(3) If in any case it appears or is represented to the Minister of Munitions that the net profits or losses of all or any other establishments belonging to the same owner should be brought into account,

[1] This section was repealed by the Finance Act of 1917, sec. 24. *Cf. infra,* p. 202.

or that the average under this section affords or may afford an unfair standard of comparison or affords no standard of comparison,[2] the Minister may, if he thinks just, allow[3] those net profits or losses to be brought into account, or substitute for the average such an amount as the standard amount of profits as may be agreed upon with the owner of the establishment.

The Minister of Munitions may, if he thinks fit, and shall, if the owner of the establishment so requires, refer the matter to be determined by a referee or board of referees appointed or designated by him for the purpose, and the decision of the referee or board shall be conclusive on the matter for all purposes.[4]

(4) The Minister of Munitions may make rules for carrying the provisions of this section into effect, and these rules shall provide for due consideration being given in carrying out the provisions of this section as respects any establishment to any special circumstances such as increase of output, provision of new machinery or plant, alteration of capital or other matters which require special consideration in relation to the particular establishment.

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II. Finance (No. 2) Act 1915
(5 & 6 George 5., ch. 89, 23rd September, 1915)

Part II

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35. Computation of profits and gains in relation to excess profits duty.—(1) Where any person has paid excess profits duty under this Act the amount so paid shall be allowed as a deduction for the purpose of income tax in computing the profits and gains of the year which included the end of the accounting period in respect of which the excess profits duty has been paid; but where any person has received repayment of any amount previously paid by him by way of excess profits duty, the amount repaid shall be treated as profit for the year in which the repayment is received.[1]

The payment of excess profits duty shall not be deemed to be a specific cause for the purposes of section one hundred and thirty-four of the Income Tax Act, 1842.

(2) Where in any income tax year the profits or gains from which a deduction may be made under this section come into computation, but owing to the time at which the amount of excess profits duty became ascertained it was impracticable to give effect to the deduction

[2] The following clause was inserted at this point in 1916: "or that no such average exists." Munitions of War (Amendment) Act, 1916, sec. 19 (5 & 6 George 5, ch. 99).

[3] The words "or require" were inserted in 1916. *Ibid.*

[4] Modified by sec. 24 (3) of Finance Act of 1917. *Cf. infra,* p. 202.

[1] *Cf.* Finance Act, 1916, sec. 48 (2), *infra,* p. 196; sec. 53, *infra,* p. 197; Finance Act, 1918, sec. 31, *infra,* p. 207 *et seq.*

when assessing income tax, the amount by which the income tax would have been reduced if effect had been given to the deduction shall be deducted from the amount payable for excess profits duty or, if there is no excess profits duty, shall be repaid to the taxpayer.

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Part III

Excess Profits Duty

38. *Charge of excess profits duty.*—(1)There shall be charged, levied, and paid on the amount by which the profits arising from any trade or business to which this Part of this Act applies, in any accounting period which ended after the fourth day of August nineteen hundred and fourteen, and before the first day of July nineteen hundred and fifteen, exceeded, by more than two hundred pounds, the pre-war standard of profits as defined for the purposes of this Part of this Act, a duty (in this Act referred to as "excess profits duty") of an amount equal to fifty per cent[1] of that excess.[2]

(2) For the purposes of this Part of this Act the accounting period shall be taken to be the period for which the accounts of the trade or business have been made up, and where the accounts of any trade or business have not been made up for any definite period, or for the period for which they have been usually made up, or a year or more has elapsed without accounts being made up, shall be taken to be such period not being less than six months or more than a year ending on such a date as the Commissioners of Inland Revenue may determine.

Where any accounting period is a period of less than a year this section shall have effect as if there were substituted for two hundred pounds a proportionately reduced amount.[3]

(3) Where a person proves that in any accounting period, which ended after the fourth day of August nineteen hundred and fourteen, his profits have not reached the point which involves liability to excess profits duty, or that he has sustained a loss in his trade or business, he shall be entitled to repayment of such amount paid by him as excess profits duty in respect of any previous accounting period, or to set off against any excess profits duty payable by him in respect of any succeeding accounting period, such an amount as will make the total amount of excess profits duty paid by him during the whole period accord with his profits or losses during that period.[4]

39. *Trades and businesses to which excess profits duty applies.*—The trades and businesses to which this Part of this Act applies are all trades or businesses (whether continuously carried on or not) of

[1] *Cf.* Finance Act, 1917, sec. 26 (4), *infra,* p. 203.

[2] *Cf.* Finance Act, 1916, sec. 45, *infra,* p. 193; Finance Act, 1917, sec. 20 (1), *infra,* p. 199; Finance Act, 1918, sec. 34, *infra,* p. 208; Finance Act, 1919, sec. 32, *infra,* p. 210; Finance Act, 1920, sec. 40, *infra,* p. 212.

[3] Finance Act, 1916, sec. 51, *infra,* p. 197.

[4] Finance Act, 1916, sec. 45 (2), *infra,* p. 193; Finance Act, 1917, secs. 22, 26 (8), *infra,* pp. 200, 204; Finance Act, 1918, sec. 35 (2) (b), *infra,* p. 208; Finance Act 1919, sec. 32 (2), *infra,* p. 210.

any description carried on in the United Kingdom, or owned or carried on in any other place by persons ordinarily resident in the United Kingdom, excepting—

(*a*) husbandry in the United Kingdom; and

(*b*) offices or employments; and

(*c*) any profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on and in which no capital expenditure is required, or only capital expenditure of a comparatively small amount,

but including the business of any person taking commissions in respect of any transactions or services rendered, and of any agent of any description (not being a commercial traveller, or an agent whose remuneration consists wholly of a fixed and definite sum not depending on the amount of business done or any other contingency).

40. *Determination of profits and pre-war standard.*—(1) The profits arising from any trade or business to which this Part of this Act applies shall be separately determined for the purpose of this Part of this Act, but shall be so determined on the same principles as the profits and gains of the trade or business are or would be determined for the purpose of income tax, subject to the modifications set out in the First Part of the Fourth Schedule to this Act and to any other provisions of this Act.

(2) The pre-war standard of profits for the purposes of this Part of this Act shall, subject to the provisions of this Act, be taken to be the amount of the profits arising from the trade or business on the average of any two of the three last pre-war trade years, to be selected by the taxpayer (in this Part of this Act referred to as the profits standard): Provided that if it is shown to the satisfaction of the Commissioners of Inland Revenue that that amount was less than the percentage standard as hereinafter defined, the pre-war standard of profits shall be taken to be the percentage standard.

The percentage standard shall, for the purposes of this Part of this Act, be taken to be an amount equal to the statutory percentage on the capital of the trade or business as existing at the end of the last pre-war trade year, subject, however, to the provisions of this Act as to any alteration in the manner of calculating the percentage standard in special cases.

The statutory percentage shall be six per cent in the case of a trade or business carried on or owned by a company or other body corporate, and seven per cent in the case of any other trade or business, subject, however, to the provisions of this Act as to the increase in that percentage in certain cases.[5]

The provisions contained in the Second Part of the Fourth Schedule to this Act shall have effect with respect to the computation of the profits of a pre-war trade year, and the provisions contained in the Third Part of the Fourth Schedule shall have effect with respect to the ascertainment of capital for the purposes of this Part of this Act.

[5] *Cf.* Finance Act, 1917, sec. 26 (2), *infra*, p. 203.

"The last pre-war trade year" means the year ending at the end of the last accounting period before the fifth day of August, nineteen hundred and fourteen, and "the three last pre-war trade years" means the three years ending at the three corresponding times.

(3) Where it appears to the Commissioners of Inland Revenue, on the application of a taxpayer in any particular case, that any provisions of the Fourth Schedule to this Act should be modified in his case, owing to a change in the constitution of a partnership, or to the postponement or suspension, as a consequence of the present war, of renewals or repairs, or to exceptional depreciation or obsolescence of assets employed in the trade or business due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war, or to any other special circumstances specified in regulations made by the Treasury, those Commissioners shall have power to allow such modifications of any of the provisions of that schedule as they think necessary in order to meet the particular case.[6]

If the Commissioners refuse, on any such application, to allow any modification, or if the applicant is dissatisfied with any modification allowed, the applicant may require the Commissioners to refer the case to a Board of Referees, to be appointed for the purposes of this Part of this Act by the Treasury, and that Board shall consider any case so referred and have the same powers with respect thereto as the Commissioners have.

41. *Adjustments for increased or decreased capital.*—(1) Where capital has been increased during the accounting period, a deduction shall be made from the profits of the accounting period at the statutory percentage per annum on the amount by which the capital has been increased, for the whole accounting period if the increased capital has been employed for the whole accounting period, and if the increased capital has been employed for part only of the accounting period, for that part of the accounting period.[7]

(2) Where capital has been decreased during the accounting period, an addition shall be made to the profits of the accounting period at the statutory percentage per annum on the amount by which the capital has been so decreased, for the whole accounting period, if the capital has been decreased for the whole accounting period, and if the capital has been decreased for part only of the accounting period, for that part of the accounting period.[8]

(3) For the purposes of this section capital shall be taken to be increased or decreased, as the case may be, where the pre-war standard of profits is a profits standard, if the capital employed in the trade or business exceeds or is less than the average amount of capital employed during the pre-war trade years or year by reference to

[6] *Cf.* Finance Act, 1916, secs. 47 (d), 55, *infra,* p. 195.

[7] Finance Act, 1916, sec. 47 (c), *infra,* p. 195; Finance Act, 1917, sec. 26 (1), *infra,* p. 203..

[8] *Cf.* Finance Act, 1917, sec. 26 (2), *infra,* p. 203.

which the profits standard has been arrived at, and, where the pre-war standard of profits is a percentage standard, if the capital exceeds or is less than the capital on which the percentage standard has been calculated.

(4) Where any capital employed in a trade or business which was so employed for the first time within three years[9] before the first day of August nineteen hundred and fourteen has only commenced to be remunerative or fully remunerative in the accounting period, an amount equal to the statutory percentage, or where interest has been earned on the capital, but at a rate less than the statutory percentage, an amount which would bring the interest earned on the capital up to the statutory percentage, as the case may be, shall be added to the profits standard.

42. *Reference to the Board of Referees of questions as to increase of percentages,* &c.—Where an application is made to the Commissioners of Inland Revenue—

(1) For an increase of the statutory percentage as respects any class of trade or business, or for a calculation of the percentage standard in the case of any class of trade or business in which the amount of capital actually employed in the trade or business is, owing to the nature of the trade or business, small compared with the capital necessarily at stake for that trade or business, by reference to some factor other than the capital of the trade or business or to some additional factor; or

(2) For an alteration of the pre-war standard of profits as respects capital employed for the purpose of the manufacture of war materials or for munitions work and which could not be expected to be remunerative or wholly remunerative, except in time of war, in a business which has been wholly or mainly carried on for those purposes;

the Commissioners, unless they are of opinion that the application is frivolous or vexatious or relates to matters already decided by a Board of Referees, shall refer the case to a Board of Referees to be appointed for the purpose of this Part of this Act by the Treasury, and that Board shall deal with the case, and may, by order, if they think fit, increase the statutory percentage or alter the percentage standard for the class of trade or business the subject of the order, or alter the pre-war standard of profits, as the case requires.[10]

On any such order being made, this Part of this Act shall have effect as from the date named in the order as if the percentage or standard named in the order was substituted for the percentage or standard fixed by this Act; and where, in pursuance of any such order, the statutory percentage is increased or the percentage standard is altered as respects any class of trade or business, the statutory percentage shall be increased and the percentage standard shall be altered re-

[9] *Cf.* Finance Act, 1917, sec. 26 (7), *infra,* p. 204.

[10] *Cf.* Finance Act, 1917, sec. 25, *infra,* p. 202.

spectively for all purposes of this Part of this Act as respects any trade or business belonging to that class.

This section shall apply to any subdivision of a trade or business based either on any special feature of the trade or business or on locality as it applies to a class of trade or business, in any case where the Board of Referees are of opinion that the subdivision can properly be dealt with separately.

43. *Excess mineral rights duty.*—(1) Where the amount payable to any person as rent in respect of the right to work minerals or of any mineral wayleaves (in cases where the right to work the minerals and the mineral wayleaves are not part of the assets of any trade or business)[11] varies according to the price of the minerals, and the amount so payable in respect of any working year ending on any date after the commencement of the present war (in this section referred to as the accounting year) exceeds the pre-war standard of that rent, there shall be paid as an addition to any mineral rights duty payable or paid, either directly or by deduction, by reference to the amount of the rent paid in that working year, by that person (in this section referred to as the person liable) an amount equal to fifty per cent of that excess.[12]

(2) The pre-war standard of rent shall, for the purposes of this section, be taken to be the average of any two of the three last pre-war rent values, to be selected by the taxpayer, and in cases where the minerals have not been worked or the wayleaves have not been let throughout the three years by reference to which the three last pre-war rent values are to be calculated, or for any other reason there are no proper data for ascertaining the pre-war rent values, shall be taken to be such amount as may be fixed by the Commissioners of Inland Revenue, having regard to the data afforded by the working and price of minerals in like circumstances, subject nevertheless to the same appeal as that to which the assessment of duty by the Commissioners is subject under Part I. of the Finance (1909-10) Act, 1910.

The pre-war rent value shall, as respects each of the three years immediately preceding the first accounting year, be taken to be the sum to which the rent for the accounting year would amount if the rent, so far as variable according to price, were based on the average prices governing the payment of the rent in that year.

(3) Any amount payable in any accounting year by the lessee of minerals or wayleaves to a superior lessor as rent in respect of the minerals or wayleaves shall be treated as a deduction from the amount payable to the lessee as rent for that year, and in computing the pre-war rent values a corresponding deduction shall be made on account of any such rent.

(4) Any increment value duty payable annually under section twenty-two of the Finance (1909-10) Act, 1910, shall, when paid,

[11] *Cf.* Finance Act, 1916, sec. 46 (2), *infra,* p. 194.

[12] Finance Act, 1916, sec. 46, *infra,* p. 194; Finance Act, 1917, sec. 21, *infra,* p. 200; Finance Act, 1919, sec. 33, *infra,* p. 210; Finance Act, 1920, sec. 41, *infra,* p. 212.

be treated as a deduction from the rent payable to any person in the year in which the duty is paid, and a corresponding deduction shall be made in computing the pre-war standard with which the rent for that year is to be compared.

(5) Any duty payable under this section shall be assessed by the Commissioners of Inland Revenue on the person liable, subject to the same appeal as that to which an assessment of duty by the Commissioners under Part I of the Finance (1909-10) Act, 1910, is subject, and shall be recoverable as a debt due to His Majesty from that person.

(6) Subsection (3) of section twenty of the Finance (1909-10) Act, 1910, shall extend so as to authorise particulars to be required of any lease of minerals or wayleaves and as to the sums paid or payable thereunder, and of such other particulars as to the minerals or wayleaves as the Commissioners may require for the purpose of this section.

(7) Expressions to which a special meaning is attached by Part I of the Finance (1909-10) Act, 1910, shall have the same meaning in this section.

44. *Returns for purpose of Part III and penalty for fictitious transactions.*—(1) The Commissioners of Inland Revenue may, for the purposes of this Part of this Act, require any person engaged in any trade or business to which this Part of this Act applies, or who was so engaged during any accounting period or pre-war trade year, to furnish them within two months after the requirement for the return is made, with returns of the profits of the trade or business during the accounting period or pre-war trade years and such other particulars in connection with the trade or business as the Commissioners may require.[13]

(2) It shall be the duty of every person chargeable to excess profits duty under this Part of this Act to give notice that he is chargeable to the Commissioners of Inland Revenue before the thirty-first day of January nineteen hundred and sixteen, and it shall be the duty of the liquidator of every company which is being wound up at the time of the commencement of this Act or is wound up after the commencement of this Act, and is chargeable to excess profits duty, to give notice of the fact to the Commissioners of Inland Revenue.

If any person fails to furnish a proper return in accordance with this section or to comply with any requirement of the Commissioners under this section, or to give any notice required by this section, he shall be liable on summary conviction to a fine not exceeding one hundred pounds and to a further fine not exceeding ten pounds a day for every day during which the offence continues after conviction therefor.

(3) A person shall not, for the purpose of avoiding the payment of excess profits duty, enter into any fictitious or artificial transaction or carry out any fictitious or artificial operation, and, if he has entered

[13] *Cf.* Finance Act, 1916, sec. 47 (c), *infra*, p. 195.

into any such transaction or carried out any such operation before the commencement of this Act, shall inform the Commissioners of Inland Revenue of the nature of the transaction or operation.

If any person acts in contravention of, or fails to comply with, this provision, he shall be liable on summary conviction to a fine not exceeding one hundred pounds.

45. *Supplemental provisions as to excess profits duty.*—(1) The excess profits duty shall be assessed by the Commissioners of Inland Revenue, and shall be payable at any time, not being less than two months, after it is assessed.

The Commissioners may, in any case where they think fit, allow the duty to be paid in instalments of such amount payable at such times as the Commissioners direct.

(2) The duty may be assessed on any person for the time being owning or carrying on the trade or business or acting as agent for that person in carrying on the trade or business, or, where a trade or business has ceased, on the person who owned or carried on the trade or business or acted as agent in carrying on the trade or business immediately before the time at which the trade or business ceased, and where there has been a change of ownership of the trade or business, the Commissioners of Inland Revenue may, if they think fit, take the accounting period as the period ending on the date on which the ownership has so changed and assess the duty on the person who owned or carried on the trade or business or acted as agent for the person carrying on the trade or business at that date.

(3) The amount of duty payable shall be recoverable as a debt due to His Majesty from the person on whom it is assessed.

Any such amount shall if it is less than fifty pounds be recoverable also summarily as a civil debt.

(4) Where a company is wound up after the commencement of this Act, and before the first day of July, nineteen hundred and sixteen, and the company would be chargeable with excess profits duty if the provisions of this Act were continued and extended to accounting periods ending before the first day of July, nineteen hundred and sixteen, it shall be the duty of the liquidator of the company to give notice to the Commissioners of Inland Revenue, and to set aside such sum out of the assets of the company as appears to the Commissioners of Inland Revenue to be sufficient to provide for any such excess profits duty as may become chargeable.

(5) Any person who is dissatisfied with the amount of any assessment made upon him by the Commissioners of Inland Revenue under this Part of this Act may (except in cases where a special right of appeal is given under this Part of this Act) appeal to the general Commissioners for the division in which he is assessed, or to the special Commissioners, and those Commissioners shall have power on any appeal, if they think fit, to summon witnesses and examine them upon oath.[14]

[14] Finance Act, 1916, sec. 47 (b), *infra,* p. 195; Finance Act, 1917, sec. 22 (2), *infra,* p. 201; Finance Act, 1918, sec. 35 (3), *infra,* p. 209.

The power under sections twenty-one and twenty-two of the Income Tax Act, 1853, to require an appeal in Ireland to the special Commissioners to be reheard by the county court judge, or chairman of quarter sessions, or recorder, shall apply to an appeal in Ireland under this provision.

Section fifty-nine of the Taxes Management Act, 1880 (which relates to the statement of a case on a point of law), shall apply with the necessary modifications in the case of any appeal to the general or special Commissioners under this section, or of the rehearing of any such appeal in Ireland, and in the case of a reference to the Board of Referees under this Part of this Act, as it applies in the case of appeals to the general or special Commissioners under the Income Tax Acts.

(6) The duty assessed by the Commissioners of Inland Revenue shall be payable notwithstanding any appeal under this section except in cases where the Commissioners of Inland Revenue direct to the contrary, but the Commissioners shall make such repayments, if any, as are necessary to give effect to any decision on appeal as soon as possible after such decision has been given.

(7) The Commissioners of Inland Revenue may make regulations with respect to the assessment and collection of the excess profits duty and the hearing of appeals under this section, and may by those regulations apply and adapt any enactments relating to the assessment and collection of income tax, or the hearing of appeals as to income tax by the general or special Commissioners, which do not otherwise apply.

(8) All Commissioners and other persons employed for any purpose in connection with the assessment or collection of excess profits duty shall be subject to the same obligations as to secrecy with respect to excess profits duty as those persons are subject to with respect to income tax, and any oath taken by any such person as to secrecy with respect to income tax shall be deemed to extend also to secrecy with respect to excess profits duty.[15]

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FOURTH SCHEDULE

Part I.—Computation of Profits

1. The profits shall be taken to be the actual profits arising in the accounting period; and the principle of computing profits by reference to any other year or an average of years shall not be followed.

2. The principle of the Income Tax Acts under which deductions are not allowed for interest on money borrowed for the purpose of the trade or business, or for rent, or royalties, or for other payments income tax on which is collected at the source (not being payments of dividends or payments for the distribution of profits), and under which profits or gains arising from lands, tenements, or hereditaments

[15] *Cf.* Finance Act, 1917, sec. 23 (3), *infra*, p. 201.

forming part of the assets of the trade or business are excluded shall not be followed.

3. Deductions for wear and tear or for any expenditure of a capital nature for renewals, or for the development of the trade or business or otherwise in respect of the trade or business, shall not be allowed except such as may be allowed under the Income Tax Acts, and if allowed shall be only of such amount as appears to the Commissioners of Inland Revenue to be reasonably and properly attributable to the year or accounting period.[1]

4. Deductions shall not be allowed on account of the liability to pay, or the payment of, income tax or excess profits duty, but a deduction shall be allowed (if not otherwise allowed by means of the adoption of the principle of the Income Tax Acts) for any sum which has been paid in respect of the profits on account of any excess profits duty or similar duty imposed in any country outside the United Kingdom.[2]

5. Any deduction allowed for the remuneration of directors, managers, and persons concerned in the management of the trade or business shall not, unless the Commissioners of Inland Revenue, owing to any special circumstances or to the fact that the remuneration of any managers or managing directors depends on the profits of the trade or business, otherwise direct, exceed the sums allowed for those purposes in the last pre-war trade year or a proportionate part thereof as the case requires, and no deduction shall be allowed in respect of any transaction or operation of any nature, where it appears, or to the extent to which it appears, that the transaction or operation has artificially reduced the amount to be taken as the amount of the profits of the trade or business for the purposes of this Act.[3]

6. Where any company, either in its own name or that of a nominee, owns the whole of the ordinary capital of any other company carrying on the same trade or business or so much of that capital as under the general law a single shareholder can legally own, the provisions of Part III. of this Act as to excess profits duty and the pre-war standard of profits shall apply as if that other company were a branch of the first-named company and the profits of the two companies shall not be separately assessed.[4]

7. Where in the case of any trade or business—

(*a*) the percentage standard is adopted as the pre-war standard of profits; and

(*b*) the net result of the trade or business during the three last pre-war trade years has shown a loss; and

(*c*) any part of the profits has been applied in extinction of that loss;

[1] *Cf.* Finance Act, 1916, sec. 39, *infra,* p. 193.

[2] *Cf.* Finance Act, 1917, sec. 23 (2), *infra,* p. 201.

[3] *Cf.* Finance Act, 1916, sec. 49, *infra,* p. 196.

[4] *Cf.* Finance Act, 1916, sec. 47 (e), *infra,* p. 195 *et seq.*

then in estimating the profits a deduction shall be allowed equal to the amount of profits so applied.[5]

8. In estimating the profits no account shall be taken of income received from investments except in the case of life assurance businesses and businesses where the principal business consists of the making of investments. Where account is taken of any such income—

(*a*) any variation in the value of any of those investments which appears to the Commissioners of Inland Revenue not to be due to a variation in profits shall also be taken into account; and

(*b*) where the income has been derived from profits in respect of which any payment or repayment of excess profits duty has been made under this Act, such deduction or addition shall be made in computing the profits as will make proper allowance for that payment or repayment of duty.

9. In computing the total profits of a local authority from any trades or businesses carried on by that authority the total amount which is required to be raised by them, out of the rates or otherwise, for sinking fund purposes in connection with those trades or businesses shall be allowed as a deduction.

10. In the case of societies registered under the Industrial and Provident Societies Acts the excess profits duty shall be charged on the sum by which the profits per member for the accounting period (including any surplus arising from transactions with members) exceed the like profits per member in the pre-war trade year or average of years taken as the basis of computation for the purpose of the pre-war standard of profits, multiplied by the number of members in the accounting period.[6]

11. In the case of any contract extending beyond one accounting period from the date of its commencement to the completion thereof and only partially performed in any accounting period there shall (unless the Commissioners of Inland Revenue, owing to any special circumstances, otherwise direct) be attributed to each of the accounting periods in which such contract was partially performed, such proportion of the entire profits or loss or estimated profits or loss in respect of the complete performance of the contract as shall be properly attributable to such accounting periods respectively, having regard to the extent to which the contract was performed in such periods.

Part II.—Pre-War Standard

1. The profits of any pre-war trade year shall be computed on the same principles and subject to the same provisions as the profits of the accounting period are computed.

2. Where the accounting period for which the excess profits duty is to be assessed is less than a year, the amount of the pre-war standard of profits shall be proportionately reduced.

3. Where it is shown to the satisfaction of the Commissioners of

[5] *Cf.* Finance Act, 1916, sec. 50, *infra,* p. 197; Finance Act, 1918, sec. 35 (2), (b), *infra,* p. 208.

[6] *Cf.* Finance Act, 1917, sec. 26 (8), *infra,* p. 204.

Inland Revenue in the case of any trade or business that the three last pre-war trade years have been years of abnormal depression, any four of the last six pre-war trade years may be substituted for the purposes of the pre-war standard of profits for any two of the three last pre-war trade years.

The three last pre-war trade years shall not be considered as years of abnormal depression unless the average profits of those years have been at least twenty-five per cent lower than the average profits of the preceding three years.

4. Where owing to the recent commencement of a trade or business there have not been three pre-war trade years, but there have been two pre-war trade years, the pre-war standard of profits shall be taken to be the amount of the profits arising from the trade or business on the average of those two years or, at the option of the taxpayer, the profits arising from the trade or business during the last of those two years, and where there have not been two pre-war trade years, but there has been one pre-war trade year, the pre-war standard of profits shall be taken to be the profits arising from the trade or business during that year; and where there has not been one pre-war trade year, the pre-war standard of profits[7] shall be taken to be the statutory percentage on the average amount of capital employed in the trade or business during the accounting period.

Where the trade or business is an agency or business of a nature involving capital of a comparatively small amount, the pre-war standard of profits shall be computed by reference to the profits arising from any trade, business, office, employment or profession of any sort, whether liable to excess profits duty or not, carried on by the agent or other person before his new trade or business commenced as if it was the same trade or business; but only to the extent to which the income from the former trade, business, office, employment or profession has been diminished.

5. Where since the commencement of the three last pre-war trade years a trade or business has changed ownership, the provisions of this Part of this Schedule shall apply as if a new trade or business had been commenced on the change of ownership, except in cases when the taxpayer makes an application that the provisions of Part III of this Act and this Schedule should apply as if the trade or business had not changed ownership, but in that case such modifications (if any) shall be made in the application of this Schedule as may be necessary to make the basis on which the profits standard is computed the same as that on which the profits of the accounting period are computed.

6. It is hereby declared that, where any business or trade is confined to the management of any particular assets, but power exists to substitute other assets for those particular assets or any of them,

[7] The statutory percentage as used in this paragraph was increased in 1917 from 6 and 7 per cent to 9 and 11 per cent, the higher rate in each case being allowed to partnerships and individuals. Finance Act, 1917, sec. 26 (1 & 2), *infra*, p. 203.

such a substitution shall not be deemed, for the purposes of Part III of this Act, to constitute a change of ownership of the business but, where any such substitution has been carried out by the sale of assets and the purchase of other assets, the capital of the trade or business shall be taken to be increased or decreased, as the case may be, only by the amount of the difference between the price of the assets purchased and the price obtained for the assets sold, and the capital representing the assets purchased shall be estimated on the same basis for all the purposes of Part III. of this Act.[8]

PART III.—CAPITAL

1. The amount of the capital of a trade or business shall, so far as it does not consist of money, be taken to be—

(*a*) so far as it consists of assets acquired by purchase, the price at which those assets were acquired, subject to any proper deductions for wear and tear or replacement, or for unpaid purchase money; and

(*b*) so far as it consists of assets being debts due to the trade or business, the nominal amount of those debts subject to any reduction which has been allowed in respect to those debts for income tax purposes; and

(*c*) so far as it consists of any other assets which have not been acquired by purchase, the value of the assets at the time when they became assets of the trade or business, subject to any proper deductions for wear and tear or replacement.

Nothing in this Part of this Schedule shall prevent accumulated profits employed in the business being treated as capital.[9]

2. Any capital the income on which is not taken into account for the purposes of Part I of this Schedule, and any borrowed money or debts, shall be deducted in computing the amount of capital for the purposes of Part III of this Act.

3. Where any asset has been paid for otherwise than in cash, the cost price of that asset shall be taken to be the value of the consideration at the time the asset was acquired, but where a trade or business has been converted into a company and the shares in the company are wholly or mainly held by the person who was owner of the trade or business, no value shall be attached to those shares so far as they are represented by goodwill or otherwise than by material assets of the company unless the Commissioners of Inland Revenue in special circumstances otherwise direct. Patents and secret processes shall be deemed to be material assets.

[8] *Cf.* Finance Act, 1916, sec. 47 (e), *infra,* p. 195.

[9] *Cf.* Finance Act, 1916, sec. 52, *infra,* p. 197.

III. Finance Act, 1916
(6 & 7 George 5., ch. 24, 19th July 1916)

Part II.—Income Tax

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39. *Repayment of income tax on sums deducted from profits under Munitions of War Act, 1915. 5 & 6 Geo. 5. c. 54.*—(1) Where in calculating for the purposes of Part II of the Munitions of War Act, 1915, the profits of a controlled establishment a deduction has been allowed under that Part of that Act or rules made thereunder in respect of exceptional depreciation or obsolescence of buildings, plant, or machinery, and the sums so deducted have not been deducted or allowed in computing the amount upon which income tax has been paid in respect of those profits, there shall be allowed a repayment of income tax equal to the amount of the income tax at the rate at which that tax has been paid on the amount of the sums so deducted:

Provided that the repayment of income tax under this section—

(*a*) shall be made in respect of the income tax year which includes the end of the period of assessment in respect of which the said deductions have been allowed under the Munitions of War Act, 1915; and

(*b*) shall be deemed to have effected a reduction of the income tax assessment by the amount upon which income tax has been so repaid.

(2) Any application for relief under this section shall be made to the Commissioners by whom the income tax assessment has been made, and those Commissioners upon proof of the facts to their satisfaction shall certify to the Commissioners of Inland Revenue the sum repayable, and the Commissioners of Inland Revenue shall cause repayment to be made accordingly.[1]

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Part III.—Excess Profits Duty

45. *Continuance and increase of rate of excess profits duty.*—(1) The Finance (No. 2) Act, 1915 (in this Part of this Act referred to as the principal Act), shall, so far as it relates to excess profits duty, apply, unless Parliament otherwise determines, to any accounting period ending on or after the first day of July nineteen hundred and fifteen and before the first day of August nineteen hundred and seventeen, as it applies to accounting periods ended after the fourth day of August nineteen hundred and fourteen and before the said first day of July.

(2) Section thirty-eight of the principal Act shall, as respects excess profits arising in any accounting period beginning after the expiration of a year from the commencement of the first accounting period, have effect as if sixty per cent of the excess were substituted as the rate of duty for fifty per cent of the excess.

[1] *Cf.* Finance Act, 1917, sec. 16 (1), *infra*, p. 198.

Where part of an accounting period is after and part before the date of the expiration of a year from the commencement of the first accounting period, the total excess profits and any deficiencies or losses arising in the accounting period shall be apportioned between the time up to and including, and the time after, that date in proportion to the length of those times respectively, and the rate attributable to the time after and the time before and including that date shall respectively be sixty and fifty per cent of the excess.

In the case of trades or businesses commencing after the fourth day of August nineteen hundred and fourteen, the rate of duty shall be sixty per cent of the excess in respect of any accounting period ending after the fourth day of August nineteen hundred and fifteen.

In calculating any repayment or set off under subsection (3) of section thirty-eight of the principal Act any amount to be repaid or set off on account of a deficiency or loss arising in any period in respect of which duty would be payable at the rate of fifty per cent of the excess, shall be calculated by reference to that rate of duty.

Any additional duty payable by virtue of this section in respect of a past accounting period may be assessed and recovered notwithstanding that duty has already been assessed in respect of that period.

(3) It shall be the duty of every person chargeable to excess profits duty under Part III of the principal Act, as extended by this Act, if he has not previously given notice of his liability to be charged with excess profits duty in respect of any accounting period, to give notice to the Commissioners of Inland Revenue before the expiration of two months after the termination of any accounting period in respect of which he is chargeable, or, if the accounting period terminated before the passing of this Act, within one month after the passing of this Act.

If any person fails to give the notice required by this provision he shall be liable on summary conviction to a fine not exceeding one hundred pounds, and to a further fine not exceeding ten pounds a day for every day during which the offence continues after conviction therefor.

46. *Increase of rate of excess mineral rights duty.*—(1) Section forty-three of the principal Act (which relates to excess mineral rights duty) shall have effect as if sixty per cent of the excess were substituted as the rate of duty for fifty per cent of the excess, in the case of minerals which have become subject to a mining lease after the fourth day of August nineteen hundred and fourteen for all accounting years, and in the case of other minerals for any accounting year ending after the completion of the first accounting year, and any additional duty may be recovered accordingly.

(2) It is hereby declared that the words in subsection (1) of section forty-three of the principal Act "assets of any trade or business" refer only to assets of the trade or business of the person receiving the rent for the right to work the minerals or for the mineral wayleaves.

47. *Computation of excess profits duty in case of sale of ships.*—

Where any ship has been sold since the fourth day of August nineteen hundred and fourteen, in such circumstances that the profits of the sale are not the profits of a trade or business, the following special provisions shall, if the Commissioners of Inland Revenue so require, be applied in the computation of the liability to excess profits duty in respect of the profits arising from the use of the ship:—

(*a*) The pre-war standard of profits of the purchaser as respects the ship shall, where the standard of the trade or business of the vendor is a profits standard, be calculated by reference to the profits arising from the use of the ship during the pre-war trade years, and shall be ascertained in accordance with the provisions of the principal Act, but calculated, where necessary, as if the use of the ship were a separate business; and where that standard is a percentage standard the pre-war standard of profits as respects the ship shall be the same as if the ship had not been sold, or, in the case of a ship which was used for the first time after the fourth day of August, nineteen hundred and fourteen, shall be calculated by reference to the capital represented by the ship at the date when it was first used; and the pre-war standard of profits of the trade or business of the vendor and of the purchaser shall respectively be reduced and increased as the case may require, with any adjustments which may be necessary to meet the case of borrowed money or unpaid purchase money or other similar matters:

(*b*) For the purpose of estimating separately the profits arising from the use of the ship, an apportionment shall, where necessary, be made of the total profits of the trade or business in which the ship has been used, regard being had to the earnings of the ship as compared with the earnings of the other assets employed in the trade or business:

Any appeal under subsection (5) of section forty-five of the principal Act, so far as it involves any question of an apportionment under this provision, shall be to the Special Commissioners:

(*c*) The power to require returns under subsection (1) of section forty-four of the principal Act shall include power for the Commissioners of Inland Revenue to require any vendor of the ship to give such information to them and to the purchaser as the Commissioners think necessary in order to enable the provisions of this section to be carried into effect.

(*d*) Nothing in subsection (3) of section forty of the principal Act or in paragraph 3 of Part I of the Fourth Schedule to the principal Act shall operate so as to enable the purchaser of the ship to obtain any greater relief than could have been obtained by the vendor if the ship had not been sold, other than relief in connection with expenditure by the purchaser on improvements or repairs:

(*e*) In the application of section forty-one of the principal Act

to any trade or business whose pre-war standard of profits has been determined or adjusted under this section any increase or decrease of capital attributable to the purchase or sale of the ship shall be disregarded, and where any such determination or adjustment has taken place both in respect of the sale of a ship and the purchase of another ship for the same trade or business, paragraph 6 of Part II of the Fourth Schedule to the principal Act shall not apply.

48. *Adjustment of excess profits duty and munitions Exchequer payments in case of controlled establishments.*—(1) The Commissioners of Inland Revenue may treat any sums actually paid in respect of munitions Exchequer payments, which appear to the Commissioners to be attributable to the same period and subject matter as that for which excess profits duty is to be paid, as a payment on account of excess profits duty, or, if the amount of the munitions Exchequer payments is larger than the amount payable as excess profits duty, as extinguishing the duty for the purposes of collection; and may arrange with the Minister of Munitions, if in any case excess profits duty is paid before the munitions Exchequer payment, for the deduction of excess profits duty payments from any sums to be collected in respect of munitions Exchequer payments which appear to the Commissioners to be attributable to the same period and subject matter as that for which the excess profits duty payments have been made, or, if the amount of the excess profits duty payments is greater than the amount to be collected on account of munitions Exchequer payments, for the extinction of the amount to be so collected.

For the purpose of determining the period to which any profits are to be attributed under this section, profits shall be deemed to accrue from day to day at a uniform rate.

(2) Any excess profits duty and any munitions Exchequer payments which are remitted under this section for the purpose of collection shall not be deemed to have been paid for the purposes of section thirty-five of the principal Act (which relates to computation of profits and gains in relation to excess profits duty) as extended by this Act.

(3) Deductions shall not be allowed on account of munitions Exchequer payments in computing profits for the purpose of excess profits duty.

49. *Provisions as to directors' fees.*—(1) Where the pre-war standard of profits is taken to be the percentage standard or is calculated by reference to the statutory percentage in the case of any trade or business owned or carried on by a company or other body corporate whose directors have a controlling interest, the Commissioners of Inland Revenue may, if they think fit, as respects any accounting period, including a past accounting period, for the purpose of the provisions relating to the statutory percentage and for the purpose of the determination and computation of profits under Part I of the Fourth Schedule to the principal Act, treat the company or body corporate as if it were a firm and not a company or body corporate and

the directors or any of them as if they were partners in the firm.

(2) If as respects any accounting period ending on or after the first day of July nineteen hundred and fifteen, the Commissioners of Inland Revenue refuse to allow a deduction in respect of any increase in the remuneration of directors of any trade or business, and the taxpayer is required to pay excess profits duty in respect of the disallowed deduction, the taxpayer shall be entitled to recover from any such director the amount which the taxpayer has paid by way of excess profits duty in respect of the increase; but any amount so recovered shall, unless the Commissioners otherwise direct, be treated as excess profits duty paid by the director from whom it is recovered and not as excess profits duty paid by the taxpayer.

(3) In this section, the expression "directors" includes any managers or persons concerned in the management of the trade or business who are remunerated out of the funds of the trade or business.

50. *Further provision as to profits applied in extinction of previous losses.*—Paragraph 7 of Part I of the Fourth Schedule of the principal Act (which allows deductions to be made in respect of profits applied in extinction of losses) shall apply to a case where the capital account of any trade or business shows a debit balance as it applies to a case where the percentage standard is adopted as the pre-war standard of profits.

51. *Provision as to accounting period.*—It is hereby declared that, for the purpose of sub-section (2) of section thirty-eight of the principal Act, any period for which the books of a trade or business have been actually made up for any interim or other purpose in such a manner that the profits for that period can be readily ascertained is (without prejudice to the powers of the Commissioners of Inland Revenue under that provision) to be taken as an accounting period, notwithstanding that under the articles of association of the company carrying on the trade or business or under any other regulations affecting the carrying on of the trade or business the accounts are also required to be made up for some other period, and notwithstanding that such accounts are not issued.

52. *Provision as to accumulating profits.*—It is hereby declared that, for the purpose of excess profits duty, profits of any trade or business arising and accumulating during any accounting period are not, during that period, to be treated as accumulated profits within the meaning of Part III of the Fourth Schedule to the principal Act, or as capital employed in the trade or business.

53. *Application of section 35 of the Finance (No. 2) Act, 1915, to munitions Exchequer payments.*—Section thirty-five of the principal Act (which relates to the computation of profits and gains for the purpose of income tax in relation to excess profits duty) shall apply to sums actually paid in respect of munitions Exchequer payments as it applies to excess profits duty, except that the relief to the taxpayer under subsection (2) of that section shall in all cases be given by means of repayment and not by deduction.

54. *Deposit of sums for payment of excess profits duty.*—Any person may deposit with the Commissioners of Inland Revenue any sums for the purpose of satisfying any excess profits duty which may thereafter become payable by him; and sums so deposited shall be applied in payment of any such duty as and when it becomes payable.

In calculating the amount to be so applied in payment of duty interest shall be allowed at such rate as may for the time being be determined by the Treasury.

55. *Amendment of section 40 (3) of the principal Act.*—Subsection (3) of section forty of the principal Act (which provides amongst other things for the reference of certain matters for the decision of a board of referees) shall, where the application for such a reference is made in respect of a trade or business carried on in a controlled establishment within the meaning of Part II of the Munitions of War Act, 1915, and relates to an accounting period during any part of which the establishment has been so controlled, and to the postponement or suspension of renewals or repairs, or to exceptional depreciation or obsolescence of assets, or to the necessity in connexion with the present war of providing plant, have effect as though a referee or board of referees appointed or designated by the Minister of Munitions for the purpose were substituted for the board of referees under the principal Act.

56. *Exemption from excess profits duty of businesses carried on under the court.*—In the case of any trade or business which by reason of its being unable to pay its debenture holders or creditors is being carried on by a liquidator, receiver, or trustee under the court, no excess profits duty shall be levied or paid until provision has been made for payment of such unpaid debenture holders or creditors.

57. *Definition.*—In this Part of this Act the expression "munitions Exchequer payments" means any sums paid into the Exchequer under section four of the Munitions of War Act, 1915, on account of the excess of the net profits of a controlled establishment.

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IV. Finance Act, 1917
(7 & 8 George 5., ch. 31, 2nd August, 1917)

Part II.—Income Tax

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16. *Repayment of income tax on sums deducted from profits.*—(1) Where a deduction on account of any of the matters specified in section thirty-nine of the Finance Act, 1916 (which provides for the repayment of income tax on sums deducted from profits) has been allowed for the purposes of excess profits duty in calculating the profits of a controlled establishment for any period during which it is subject to control, that section shall, subject to the necessary modifications, apply as it applies where a deduction has been allowed in

calculating those profits for the purposes of Part II of the Munitions of War Act, 1915 (5 & 6 Geo. 5. c. 54):

Provided that a repayment of income tax shall not be allowed under this section and also under the said section thirty-nine in respect of the same deduction.

(2) Subsection (3) of section twenty-six of the Finance Act, 1907 (7 Edw. 7. c. 13), shall apply, with the necessary modifications, with respect to any repayment of income tax under the said section thirty-nine or this section, as it applies with respect to deductions for wear and tear.

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Part III

Excess Profits Duty

20. *Continuance and increase of rate of excess profits duty.*—(1) The Finance (No. 2) Act, 1915 (in this Part of this Act referred to as the principal Act), shall, so far as it relates to excess profits duty, apply, unless Parliament otherwise determines, to any accounting period ending on or after the first day of August nineteen hundred and seventeen and before the first day of August nineteen hnudred and eighteen, as it applies to accounting periods ended after the fourth day of August nineteen hundred and fourteen and before the first day of August nineteen hundred and seventeen.

(2) Section thirty-eight of the principal Act shall, as respects excess profits arising in any accounting period commencing on or after the first day of January nineteen hundred and seventeen, have effect as if eighty per cent of the excess were substituted as the rate of duty for sixty per cent of the excess, or, in the case of an accounting period which commenced before that date but ends after that date, as if eighty per cent were substituted for sixty per cent as respects so much of the excess as may be apportioned under this Act to the part commencing on that date.

In calculating any repayment or set off under subsection (3) of section thirty-eight of the principal Act any amount to be repaid or set off on account of a deficiency or loss arising in any accounting period commencing on or after the first day of January nineteen hundred and seventeen, or, in the case of an accounting period which has commenced before that date but ends after that date, on account of so much of the deficiency or loss as may be apportioned under this Act to the part commencing on that date, shall be calculated by reference to duty at the rate of eighty per cent.

Any additional duty payable by virtue of this section in respect of a past accounting period may be assessed and recovered notwithstanding that duty has already been assessed in respect of that period.

(3) It shall be the duty of every person chargeable to excess profits duty, if he has not previously given notice of his liability to be charged with excess profits duty in respect of any accounting period, to give notice to the Commissioners within two months after

the termination of any accounting period in respect of which he is chargeable, or, if the accounting period terminated before the passing of this Act, within one month after the passing of this Act.

If any person fails to give the notice required by this provision he shall be liable on summary conviction to a fine not exceeding one hundred pounds, and to a further fine not exceeding ten pounds a day for every day during which the offence continues after conviction therefor.

21. *Increase of rate of excess mineral rights duty.*—Section forty-three of the principal Act (which relates to excess mineral rights duty) shall have effect as if eighty per cent of the excess were substituted as the rate of duty for sixty per cent for any accounting year commencing on or after the first day of January nineteen hundred and seventeen, or, in the case of an accounting year which commenced before that date but ends after that date, as if eighty per cent were substituted for sixty per cent as respects so much of the excess as may be apportioned under this Act to the part commencing on that date, and any additional duty may be recovered accordingly:

Provided that where it is shown to the satisfaction of the Commissioners that the amount payable as rent under any lease or agreement for a lease for any accounting year in respect of which or any part of which excess mineral rights duty is payable at the rate of eighty per cent is not greater than the average amount payable as rent for the two pre-war years the prices in which are selected by the taxpayer for the purpose of determining the pre-war rent values of the rent for the accounting year, or would be reduced below that amount by the payment of excess mineral rights duty, no excess mineral rights duty or, as the case may be, such an amount of excess mineral rights duty only as will reduce the amount payable as rent for the accounting year to the said average amount, shall be paid for that accounting year.[1]

22. *Special provisions as to deficiencies and losses of shipping concerns.*—(1) In computing the excess profits duty of any trade or business which consists wholly or partly of the business of shipping the provisions of subsection (3) of section thirty-eight of the principal Act (which relate to the repayment or setting off of duty on account of deficiencies or losses) shall not apply in relation to any deficiency or loss in any accounting period commencing on or after the first day of January nineteen hundred and seventeen, and in the case of an accounting period which has commenced before that date but ends after that date, shall not apply in relation to so much of the deficiency or loss as may be apportioned under this Act to the part commencing on that date:

Provided that—

(*a*) where the shipping business is carried on merely as ancillary to the principal trade or business, the provisions of this section shall not apply;

[1] Finance Act, 1919, sec. 32 (2), *infra*, p. 210.

(*b*) where the trade or business carried on does not consist wholly of shipping, and the part which does not consist of shipping is not merely ancillary to the business of shipping, such apportionment of any deficiency or loss shall be made by the Commissioners as may be necessary to limit the application of this section to such part of the business as consists of shipping; and

(c) if in any such accounting period as aforesaid there has been a loss or the profits have not reached the point which would have involved liability to excess profits duty if the percentage standard had been adopted, the same amount shall, as respects the deficiency or loss or so much thereof as is affected by this section, be repaid or set off under subsection (3) of the said section thirty-eight as would have been repaid or set off if the percentage standard had been adopted.

(2) Any appeal under subsection (5) of section forty-five of the principal Act on any question arising under this section shall be to the Special Commissioners.

(3) In this section the expression "business of shipping" means the business carried on by an owner of ships, and for the purposes of this definition the expression "owner" includes any charterer to whom a ship is demised.

23. *Relief in respect of Colonial excess profits duty.*—(1) His Majesty may by Order in Council declare—

(*a*) that under the law in force in any of His Majesty's possessions[2] excess profits duty is chargeable in respect of any profits in respect of which excess profits duty is also payable in the United Kingdom; and

(*b*) that arrangements have been made with the Government of any such possession whereby, in respect of any profits, only the duty which is higher in amount is to be payable, and the amount of such duty is to be apportioned between the respective Exchequers in proportion to the amount of duty which would otherwise have been payable in the United Kingdom and in that possession respectively.

(2) Where any such Order in Council is made, then, if the Commissioners are satisfied that any case is one to which any such arrangements relate, they may, in lieu of any relief granted under paragraph 4 of Part I of the Fourth Schedule to the principal Act, allow or make such remission or adjustments of duty as may be necessary to give effect to such arrangements, so, however, that the effect of such remission or adjustments shall not be less favourable than the relief in lieu of which they are allowed or made.

(3) The obligation as to secrecy imposed by subsection (8) of section forty-five of the principal Act shall not prevent the disclosure to the Government of the possession concerned of such facts as may be necessary to enable such arrangements as aforesaid to be carried into effect.

[2] *Cf.* Finance Act, 1919, sec. 34, *infra,* p. 211.

24. *Further provisions with respect to munitions Exchequer payments.*—(1) The provisions of section four of the Munitions of War Act, 1915, with respect to munitions Exchequer payments shall not apply to any profits arising after the thirty-first day of December nineteen hundred and sixteen or apportioned under this Act to the period after that date.

(2) Munitions Exchequer payments arising on or before the thirty-first day of December nineteen hundred and sixteen, or apportioned under this Act to the period down to and including that date shall, after the passing of this Act, be assessed and collected, or, if already assessed but not collected, collected, by the Commissioners, and shall be computed by them in accordance with the provisions of that Act and the rules made thereunder, and the Commissioners shall for those purposes have all the powers of the Minister of Munitions, including the power of making rules.

For the purposes of such assessment and collection, the provisions for the time being in force with respect to the assessment and collection of excess profits duty (including provisions as to returns and penalties, but excluding provisions imposing any charge of duty or as to the computation of duty) shall apply, and rules may be made by the Commissioners accordingly, and the provisions of section forty-eight of the Finance Act, 1916, relating to the adjustment of excess profits duty and munitions Exchequer payments, shall apply subject to such modifications as may be necessary in consequence of the transfer of powers effected by this subsection.

Any rules made by the Commissioners may specify matters which may be referred to the Minister, or to a referee or board of referees appointed by him, and prescribe the manner in which such cases are to be referred.

(3) For the purposes of subsection (3) of section five of the said Act, any establishments in which the same person has a controlling or preponderating interest may, if the Commissioners so determine, be treated as belonging to the same owner.

(4) Subsections (2) and (3) of section forty-nine of the Finance Act, 1916 (which relate to the recovery of payments in respect of increased directors' fees), shall apply for the purposes of munitions Exchequer payments as they apply for the purposes of excess profits duty, with the necessary modifications.

25. *Additional powers of reference to referees.*—Notwithstanding anything contained in section forty-two of the principal Act (which provides for the reference to the Board of Referees of questions as to percentages, &c.) the Commissioners may, if they think fit, refer to the Board of Referees any application made under that section as respects a class of trade or business, although the application may relate to matters already decided by that Board, and the Board may, if they think fit, on cause being shown by additional evidence or otherwise, re-open the case and make any order which they could have made on an application relating to matters not already decided

by them, and may revise any order previously made by them affecting that class of trade or business; and any such order or revised order shall, as from such date as may be specified therein, apply and have effect in lieu of any previous order relating to the same matter.

26. *Amendments of law as respects accounting periods ending after December 31st, 1916.*—In the application of Part III of the principal Act to excess profits duty for any accounting period ending after the thirty-first day of December nineteen hundred and sixteen, the following provisions shall have effect:—

(1) In ascertaining the deduction to be made from the profits of the accounting period in respect of increased capital, or the pre-war standard of profits in cases where there has not been one pre-war trade year, three per cent. shall be added to the statutory percentage per annum; and, accordingly, in subsection (1) of section forty-one of, and paragraph 4 of Part II of the Fourth Schedule to, the principal Act, the expression "statutory percentage" shall be taken to mean the statutory percentage as so increased:

(2) The statutory percentage shall, in the case of a trade or business not carried on or owned by a company or other body corporate, be taken to be eight per cent instead of seven per cent; and accordingly subsection (2) of section forty of the principal Act shall have effect as though eight per cent were substituted for seven per cent:

Provided that nothing in this provision shall affect the amount of the statutory percentage for the purposes of subsection (2) of section forty-one of the principal Act:

(3) Any increase of the statutory percentage under this section shall be in addition to any increase of the statutory percentage which has, before the passing of this Act, been made under section forty-two of the principal Act:

(4) Where the pre-war standard of profits of any trade or business does not exceed five hundred pounds, and the profits of the accounting period, after any adjustment in respect of increased or decreased capital, are less than two thousand pounds, subsection (1) of section thirty-eight of the principal Act shall have effect as though for two hundred pounds there were substituted two hundred pounds with the addition of one-fifth of the amount by which the profits of the accounting period are less than two thousand pounds; so, however, that if there has been a loss in the accounting period, then for the purpose of ascertaining the amount of any repayment or set-off under the principal Act the addition allowed shall be such as if there had been neither loss nor profit, and that where the accounting period is a period of less than a year, this provision shall have effect as if there were substituted for two thousand pounds and two hundred pounds respectively a proportionately reduced amount:

The foregoing provision shall apply where the pre-war standard of profits exceeds five hundred pounds, subject to this qualification, that the amount of the addition shall be reduced by the amount by which the pre-war standard exceeds five hundred pounds:

(5) Where the Commissioners are satisfied—

(*a*) that in connection with any trade or business two or more distinct and independent industries are carried on in separate establishments, and with books kept in such a manner that the profits in respect of each industry can be readily ascertained; and

(*b*) that in any year by reference to which the pre-war standard of profits is calculated a loss has been sustained in respect of any one or more of such industries;

the Commissioners may, if they think fit, in computing the profits standard, disregard that loss:

(6) Where the Commissioners are satisfied that during the last six pre-war trade years, owing to trading losses—

(*a*) any former assets of any trade or business have ceased to form part of the assets of that trade or business; or

(*b*) the money borrowed in respect of the trade or business or the debts of the trade or business have increased;

the Commissioners shall, for the purpose of ascertaining the capital of the trade or business in any case where the percentage standard is adopted, compute the capital as though there had been no such loss of assets or increase of borrowed money or debts:

(7) Six years shall be substituted for three years in subsection (4) of section forty-one of the principal Act (which provides for the adjustment of excess profits duty in respect of unremunerative capital).

(8) The excess profits duty of a society registered under the Industrial and Provident Societies Acts may, if the society so requires, instead of being computed as provided for by paragraph 10 of Part I of the Fourth Schedule to the principal Act, be computed as follows:—

The amount of excess profits (if any) arising on commercial transactions with non-members shall be separately ascertained in accordance with the general principles of the principal Act, and there shall be added thereto the amount (if any) by which the profit or surplus arising from transactions with members per pound sterling of turnover in the accounting period exceeds the like profit or surplus in the pre-war trade year or average of years taken as the basis of computation for the purpose of the pre-war standard of profits in respect of such commercial transactions as aforesaid, multiplied by the number of pounds sterling of turnover in the accounting period; and excess profits duty shall be charged on the sum of those amounts:

Provided that the method of computation hereby laid down shall not be adopted for ascertaining the amount of any deficiency or loss for the purposes of subsection (3) of section thirty-eight of the principal Act, nor shall any duty computed under this provision be repaid or remitted by reason of a deficiency or loss in any other accounting period computed as provided for by the said paragraph 10.

Regulations made by the Commissioners for the purpose of carrying the foregoing provision into effect may provide for defining and ascertaining turnover and the profit or surplus per pound sterling thereof, and for the application of that provision to new societies, and for extending, subject to such modifications as may be prescribed, to cases where duty is computed under that provision any of the general principles of the principal Act as to relief from duty.

27. *Apportionment of accounting periods and years.*—Where part of an accounting period or of an accounting year, or of any period in respect of part of which munitions Exchequer payments are chargeable, is after, and part before, the beginning of the first day of January nineteen hundred and seventeen, the total excess profits and any deficiencies or losses arising in any such accounting period, and the total excess rent for any such accounting year, and the total profits in respect of part of which munitions Exchequer payments are chargeable, shall be apportioned between the time up to, and the time after, that date in proportion to the number of months or fractions of months before and after that date respectively.

28. *Interpretation.*—In this Part of this Act references to the principal Act, or to the Munitions of War Act, 1915, or to any provisions of those Acts, shall be construed as references to those Acts or provisions as amended by any subsequent enactment, and the expression "the Commissioners" means the Commissioners of Inland Revenue, and the expression "munitions Exchequer payments" in this Part of this Act and in any other enactment, includes any sums payable into the Exchequer under section four of the Munitions of War Act, 1915, on account of the excess of the net profits of a controlled establishment.

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Part VI

National Debt and Loans

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34. *Power to transfer war stock and bonds in satisfaction of death duties and excess profits duties.*—(1) The Treasury may by regulations prescribe as securities to be accepted in payment of any death duty or excess profits duty or munitions Exchequer payments any stock or bonds forming part of any issue made for raising money in connection with the present war, and any such regulations may specify different securities in respect of different duties and payments, and

may prescribe the limitations and conditions subject to which any securities will be accepted, and any person from whom any sum is due on account of any death duty or excess profits duty or munitions Exchequer payments may pay that sum or any part thereof by means of the transfer, in accordance with and subject to the provisions of such regulations as aforesaid, to the Commissioners of Inland Revenue of an appropriate amount (ascertained as hereinafter mentioned) of any stock or bonds authorised by the regulations.

(2) Any stock or bonds so transferred shall be accepted by the Commissioners of Inland Revenue in satisfaction of the amount.

(3) Any stock or bonds so transferred shall be deemed to mature for payment on the date of the transfer, but the principal payable on maturity shall be deemed to be a sum equal to the price of issue, and the principal and interest of the stock or bonds when received by the Commissioners of Inland Revenue shall be brought to account as revenue in such manner as the Treasury may direct.[1]

(4) Stock or bonds so transferred shall for the purposes of this section be valued at the price of issue with the addition of any interest accrued due at the date of transfer but then remaining unpaid, after deducting the amount of any interest which may be receivable by the transferor after that date:[1]

Provided that in the case of excess profits duty and munitions Exchequer payments—

(*a*) if the transfer takes place after the date when the duty or payments become payable there shall be deducted from the value so attributed to the stock or bonds the amount of any interest which accrued due on the stock or bonds after that date; and

(*b*) if the transfer takes place before that date, a sum equal to the value thereof so ascertained as aforesaid shall be deemed to be money deposited under section fifty-four of the Finance Act, 1916, and interest thereon shall be allowed in accordance with that section.

(5) For the purposes of this section interest shall be deemed to accrue from day to day.

(6) Section sixty-one of the Finance Act, 1916, is hereby repealed.

V. Finance Act, 1918
(8 & 9 George 5., ch. 15, 30th July, 1918)

Part II

Income Tax

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24. *Provision with respect to deductions for wear and tear of plant, &c.*—(1) Where an application is made to the Commissioners of Inland Revenue for the alteration of the amount of any deduction for wear and tear, the Commissioners, unless they are of opinion that the

[1] *Cf.* Finance Act, 1918, sec. 42, *infra*, p. 209.

application is frivolous or vexatious, shall refer the case to the Board of Referees, and that Board shall, if they are satisfied that the application is made by or on behalf of any considerable number of persons engaged in any class of trade or business, take the application into their consideration, and determine the deduction to be allowed.

In this section—

The expression "deduction for wear and tear" has the same meaning as in section twenty-six of the Finance Act, 1907; and

The expression "Board of Referees" means any Board of Referees appointed for the purpose of Part III of the Finance (No. 2) Act, 1915, or, if there is no such Board, a Board of Referees to be appointed for the purpose of this section by the Treasury.

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(3) In estimating the profits or gains of any trade, manufacture, adventure, or concern in the nature of trade chargeable under Schedule D., or the profits of any concern chargeable by reference to the rules of that Schedule, there shall be allowed to be deducted as expenses incurred in any year so much of any amount expended in that year in replacing any plant or machinery which has become obsolete as is equivalent to the cost of the plant or machinery replaced after deducting from that cost the total amount of any allowances which have at any time been made in estimating profits or gains as aforesaid on account of the wear and tear of that plant and machinery and any sum realized by the sale of that machinery or plant.

(4) *61 & 62 Vict. c. 10.*—Section nine of the Finance Act, 1898 (which relates to the amount of the deduction to be allowed on account of the annual value of premises), shall not apply in the case of any premises being mills, factories, or other similar premises.

25. *Basis of charge where non-resident is chargeable in name of agent in respect of profits arising from the sale of foreign goods.*—Where a non-resident person is chargeable to income tax in the name of any branch, manager, agent, factor, or receiver in respect of any profits or gains arising from the sale of goods or produce manufactured or produced out of the United Kingdom by the non-resident person, the person in whose name the non-resident person is so chargeable may, if he thinks fit, apply to the Commissioners by whom the assessment is made or, in case of an appeal, to the General or Special Commissioners to have the assessment to income tax in respect of those profits or gains made or amended on the basis of the profits which might reasonably be expected to have been earned by a merchant or, where the goods are retailed by or on behalf of the manufacturer or producer, by a retailer of the goods sold who had bought from the manufacturer or producer direct, and, on proof to the satisfaction of the Commissioners concerned of the amount of the profits on the basis aforesaid, the assessment shall be made or amended accordingly.

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31. *Excess profits duty charged in respect of profits arising from*

the sale of trading stock not to be allowed as a deduction.—Any excess profits duty which becomes chargeable by virtue only of the provisions of this Act relating to profits arising from the sale of trading stock, otherwise than in the ordinary course of trade, shall not for the purpose of the provisions of section thirty-five of the Finance (No. 2) Act, 1915, which enacts that, where a person has paid excess profits duty under that Act, the amount so paid shall be allowed as a deduction in computing profits and gains for the purpose of income tax, be deemed to be excess profits duty under that Act.

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PART III

EXCESS PROFITS DUTY

34. *Continuation of excess profits duty.*—The Finance (No. 2) Act, 1915 (in this Part of this Act referred to as "the principal Act"), as amended or extended by any subsequent enactment, shall, so far as it relates to excess profits duty, apply, unless Parliament otherwise determines, to any accounting period ending on or after the first day of August, nineteen hundred and eighteen, and before the first day of August, nineteen hundred and nineteen, as it applies to accounting periods ended after the fourth day of August, nineteen hundred and fourteen, and before the first day of August, nineteen hundred and eighteen.

35. *Profits arising from sale of trading stock.*—(1) For the purposes of excess profits duty the profits arising from the sale at any time after the twenty-second day of April, nineteen hundred and eighteen, otherwise than in the ordinary course of trade of the trading stock or part of the trading stock belonging or formerly belonging to any trade or business, shall be deemed to be profits arising from a trade or business, and where any such sale takes place after a trade or business has ceased the trade or business shall be deemed to have been carried on up to and including the date on which the sale takes place, and the accounting period shall be taken to be such as the Commissioners of Inland Revenue may determine.

(2) Where a trade or business has ceased but is deemed for the purposes of this section to have been carried on for any period—

(*a*) the person by whom or by whose authority any trading stock is sold whether as owner, agent, liquidator, trustee, or receiver or other person acting in a similar capacity shall be deemed to be the person carrying on the trade or business and excess profits duty shall be assessed on and recoverable from that person and nothing in subsection (2) of section forty-five of the principal Act shall operate so as to impose any liability to duty on the purchaser of the trading stock; and

(*b*) the appointment of any such liquidator, trustee or receiver, or other person shall not be treated as a change of ownership of the trade or business, and subsection (3) of section thirty-eight of the principal Act and paragraph seven of Part I of the

Fourth Schedule to that Act as amended by any subsequent enactment shall have effect as if the profits arising from the sale of the trading stock had been made by the owner of the business immediately before the appointment of the liquidator, trustee, receiver, or other person, and as if the duty were payable by him.

(3) Where any trading stock is sold together with other assets of the trade or business, the part of the consideration attributable to the trading stock shall, subject to appeal in manner provided by subsection (5) of section forty-five of the principal Act, be determined by the Commissioners of Inland Revenue, and the part of the consideration so determined shall be deemed to be the price paid for the trading stock by the purchaser.

(4) For the purpose of this section any trading stock which has been disposed of otherwise than by way of sale shall be deemed to have been sold, and any such trading stock so disposed of, and any trading stock which has been sold for a consideration other than cash, not being a consideration the value of which can be easily ascertained, shall be deemed to have realized the market price of the day on which it was so disposed of or sold.

No person shall at any time after the fourteenth day of May, nineteen hundred and eighteen, dispose otherwise than by way of sale of any trading stock unless he has previously made provision to the satisfaction of the Commissioners of Inland Revenue for securing the payment of any excess profits duty which may be chargeable by virtue of the provisions of this section, and if any person attempts to dispose of any trading stock in contravention of this provision the disposal shall be void and of no effect.

(5) In this section the expression "trading stock" includes—

(*a*) any goods such as are sold in the ordinary course of a trade or business whether in a finished condition or not; and

(*b*) any raw or other materials used in the manufacture or preparation of any such goods,

and references to disposal of trading stock do not include disposal by way of testamentary disposition.

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Part V

General

42. *Amendment of s. 34 of 7 & 8 Geo. 5. c. 31.*—Section thirty-four of the Finance Act, 1917, shall have effect as though there were inserted therein after the words "price of issue," in subsection (3) and subsection (4) thereof, the words "or such other price as was specified in the conditions subject to which the stock or bonds were issued as the price at which the stock or bonds were to be valued for the purposes of this section."

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VI. Finance Act, 1919

(9 & 10 George 5., ch. 32, 31st July, 1919)

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Part IV

Excess Profits Duty

32. *Continuance of excess profits duty at decreased rate.*—(1) The Finance (No. 2) Act, 1915 (in this Part of this Act referred to as "the principal Act"), shall, so far as it relates to excess profits duty, apply, unless Parliament otherwise determines, to any accounting period ending on or after the first day of August nineteen hundred and nineteen, and before the fifth day of August nineteen hundred and twenty, as it applies to accounting periods ended after the fourth day of August nineteen hundred and fourteen, and before the first day of August nineteen hundred and nineteen.

(2) Section thirty-eight of the principal Act shall, as respects excess profits arising in any accounting period commencing on or after the first day of January, nineteen hundred and nineteen, have effect as if forty per cent of the excess were substituted as the rate of duty for eighty per cent of the excess, or, in the case of an accounting period which commenced before that date but ends after that date, as if forty per cent were substituted for eighty per cent as respects so much of the excess as may be apportioned under this Part of this Act to the part commencing on that date.

In calculating any repayment or set off under subsection (3) of section thirty-eight of the principal Act, any amount to be repaid or set off on account of a deficiency or loss arising in any accounting period commencing on or after the first day of January, nineteen hundred and nineteen, or, in the case of an accounting period which has commenced before that date but ends after that date, on account of so much of the deficiency or loss as may be apportioned under this Part of this Act to the part commencing on that date, shall be calculated by reference to duty at the rate of forty per cent.

33. *Decrease of rate of excess mineral rights duty.*—(1) Section forty-three of the principal Act (which relates to excess mineral rights duty) shall have effect as if forty per cent of the excess were substituted as the rate of duty for eighty per cent for any accounting year commencing on or after the first day of January, nineteen hundred and nineteen, or, in the case of an accounting year which commenced before that date but ends after that date, as if forty per cent were substituted for eighty per cent as respects so much of the excess as may be apportioned under this Part of this Act to the part commencing on that date.

(2) The proviso to section twenty-one of the Finance Act, 1917, shall apply to any accounting year in respect of which or any part of which excess mineral rights duty is payable at the rate of forty per cent, as it applies where the said duty is payable at the rate of eighty per cent.

34. *Extension of relief in respect of Colonial excess profits duty.*—Section twenty-three of the Finance Act, 1917 (which provides for relief in respect of Colonial excess profits duty), shall have effect, and shall be deemed always to have had effect, as though references to His Majesty's possessions included references to any territory under His Majesty's protection.

35. *Apportionment of accounting periods and years.*—Where part of an accounting period or of an accounting year is after, and part before, the beginning of the first day of January, nineteen hundred and nineteen, the total excess profits and any deficiencies or losses arising in any such accounting period, and the total excess rent for any such accounting year, shall be apportioned between the time up to, and the time after, that date in proportion to the number of months or fractions of months before and after that date respectively.

36. *Interpretation.*—In this Part of this Act references to the principal Act, or to any provisions of that Act, shall be construed as references to that Act, or those provisions, as amended or extended by any subsequent enactment.

APPENDIX B

TEXT OF FINANCE ACT, 1920, AMENDING EXCESS PROFITS DUTY
(10 & 11 Geo. 5, ch. 18, 4th Aug., 1920)

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PART IV

EXCESS PROFITS DUTY

44. *Continuance and increase of rate of excess profits duty.*—(1) The Finance (No. 2) Act, 1915 (in this Part of this Act referred to as "the principal Act," 5 & 6 Geo. 5. c. 89), shall, so far as it relates to excess profits duty, apply, unless Parliament otherwise determines, to any accounting period ending on or after the fifth day of August nineteen hundred and twenty, and before the fifth day of August nineteen hundred and twenty-one, as it applies to accounting periods ended after the fourth day of August, nineteen hundred and fourteen, and before the fifth day of August, nineteen hundred and twenty.

(2) Section thirty-eight of the principal Act shall, as respects excess profits arising in any accounting period commencing on or after the first day of January, nineteen hundred and twenty, have effect as if sixty per cent of the excess were substituted as the rate of duty for forty per cent of the excess, or, in the case of an accounting period which commenced before that date but ends after that date, as if sixty per cent were substituted for forty per cent as respects so much of the excess as may be apportioned under this Part of this Act to the part commencing on that date.

In calculating any repayment or set off under subsection (3) of section thirty-eight of the principal Act any amount to be repaid or set off on account of a deficiency or loss arising in any accounting period commencing on or after the first day of January, nineteen hundred and twenty, or, in the case of an accounting period which has commenced before that date but ends after that date, on account of so much of the deficiency or loss as may be apportioned under this Part of this Act to the part commencing on that date, shall be calculated by reference to duty at the rate of sixty per cent.

Any additional duty payable by virtue of this section in respect of a past accounting period may be assessed and recovered notwithstanding that duty has already been assessed in respect of that period.

(3) In the case of a trade or business which is owned or carried on by any person who has served during the war as a member of any of the naval or military forces of the Crown, or of the Air Force or in service of a naval or military character in connection with the war for which payment was made out of money provided by Parliament, or in any work abroad of the British Red Cross Society or the Order of St. John of Jerusalem or any other body with similar objects, and which was commenced by that person for the first time, or having been wholly discontinued by him during the war or some part of the war was recommenced by him, after his demobilisation or discharge, subsection (1) of section thirty-eight of the principal Act

shall have effect as though "five hundred pounds" were substituted for "two hundred pounds."

45. *Amendments as respects pre-war standard in accounting periods ending after 31st December 1919.*—In the application of Part III. of the principal Act to excess profits duty for any accounting period ending after the thirty-first day of December, nineteen hundred and nineteen, the following provisions shall have effect:—

(1) For the pre-war standard of profit there shall, on the application of the taxpayer, be substituted a standard (in this section referred to as "the substituted standard") of an amount equal in the case of a trade or business which had no pre-war trade year to the statutory percentage on the average amount of capital employed in the first accounting period, and in the case of any other trade or business to the percentage standard with the addition in either case of a sum of five hundred pounds in respect of each working proprietor in the trade or business:

Provided that—

(*a*) the amount of the substituted standard shall not, as respects any trade or business, exceed the sum of seven hundred and fifty pounds in respect of each working proprietor in the trade or business; and

(*b*) in computing the profits of a trade or business in any accounting period as respects which the substituted standard is in force, no deduction shall be allowed in respect of the remuneration of any working proprietor; and

(*c*) where the accounting period is less than a year the substituted standard shall be proportionately reduced; and

(*d*) where a substituted standard has been adopted in the case of any trade or business for any accounting period the provisions of paragraph (4) of section twenty-six of the Finance Act, 1917, as amended by this Part of this Act, shall not have effect as regards that trade or business in respect of that accounting period.

(*e*) Nothing in this paragraph shall affect the operation of any agreements made between the Food Controller and the owners of controlled flour mills which provide for determining the amount of any payment to be made or received under such agreements by reference to the pre-war standard of profits, and any such agreements shall have effect as if this Act had not passed.

In this paragraph—

The expression "trade or business" means any trade or business carried on either by an individual or by persons in partnership or by a private company within the meaning of the Companies (Consolidation) Act, 1908;

The expression "proprietor" means, as the case may be, the individual carrying on the business, any partner in the partnership, or any director of the company owning not less than twenty per cent of the share capital or stock of the company;

The expression "working proprietor" means a proprietor who has, during not less than one half the accounting period, worked full time in the actual management or conduct of the trade or business, but no person shall be deemed to be a working proprietor in the same accounting period in respect of more than one trade or business;

Where any person who served during the war as a member of any of the naval or military forces of the Crown or of the Air Force or in service of a naval or military character in connection with the war, for which payment was made out of moneys provided by Parliament, or in any work abroad of the British Red Cross Society or the Order of St. John of Jerusalem or any other body with similar objects, and was before entering on such service working full time in the actual management or conduct of a trade or business, has died and the trade or business is being carried on for the benefit of his widow, the same standard shall be allowed for the trade or business as would have beeen allowed under the foregoing provisions of this section if the deceased person had been a working proprietor during the accounting period.

(2) Any trade or business carried on or owned by a company or other body corporate whose directors have a controlling interest shall, for the purpose of the provisions of the principal Act relating to the statutory percentage as amended by any other enactment, be treated as if it were a trade or business carried on or owned by a body other than a body corporate:

In this paragraph the expression "director" includes any person engaged in the management of the trade or business whose remuneration is provided out of the funds of the trade or business.

(3) In paragraph (4) of Part II. of the Fourth Schedule to the principal Act the words "during the first accounting period" shall be substituted for the words "during the accounting period."

46. *Amendment of ss. (3) of s. 38 of 5 & 6 Geo. 5. c. 89, with respect to munitions exchequer payments.*—For the purposes of any claim to repayment or set-off under subsection (3) of section thirty-eight of the principal Act (which provides for the repayment of excess profits duty paid and for a set-off against excess profits duty payable), any sum paid by the claimant by way of munitions exchequer payments shall be treated as though it were a sum paid by way of excess profits duty.

47. *Amendments of s. 26 of 7 & 8 Geo. 5. c. 31 as respects accounting periods ending after 31st December 1919.*—In the application of Part III. of the principal Act to excess profits duty for any accounting period ending after the thirty-first day of December, nineteen hundred and nineteen, section twenty-six of the Finance Act, 1917, shall have effect as though in paragraph (1) "five per cent" were substi-

tuted for "three per cent," and as though in paragraph (4) for the words "five hundred pounds" and "two thousand pounds," respectively, wherever those words occur, there were substituted the words "two thousand pounds" and "four thousand pounds," respectively.

48. *Allowance in respect of charitable contributions.*—Where, out of the profits of a trade or business, any contribution has been made after the sixteenth day of July, nineteen hundred and twenty, to any trust, society, or body of persons in the United Kingdom established solely for the purpose of the relief of the poor or the sick, or for the advancement of religion, education, or for scientific research, there shall, for the purposes of excess profits duty, be allowed, in the computation of the profits of the trade or business arising in the accounting period within which such contribution was made, a deduction in respect of such contribution of an amount not exceeding five per cent of those profits as calculated for the purposes of excess profits duty (before adjustment for increased or decreased capital and before making any deduction under this section), and not exceeding twenty per cent of the amount of such contribution.

This section shall not apply to any contribution which, apart from the provisions of this section, would be admissible as a deduction from profits for the purposes of excess profits duty.

49. *Increase of rate of excess mineral rights duty.*—(1) Section forty-three of the principal Act (which relates to excess mineral rights duty) shall have effect as if sixty per cent of the excess were substituted as the rate of duty for forty per cent for any accounting year commencing on or after the first day of January, nineteen hundred and twenty, or, in the case of an accounting year which commenced before that date but ends after that date, as if sixty per cent were substituted for forty per cent as respects so much of the excess as may be apportioned under this Act to the part commencing on that date, and any additional duty may be recovered accordingly.

(2) The proviso to section twenty-one of the Finance Act, 1917 (*7 & 8 Geo. 5. c. 31*), shall apply to any accounting year in respect of which or any part of which excess mineral rights duty is payable under this Part of this Act at the rate of sixty per cent, as it applies where the said duty is payable at the rate of eighty per cent.

50. *Apportionment of accounting periods and years.*—Where part of an accounting period or of an accounting year is after, and part before, the beginning of the first day of January, nineteen hundred and twenty, the total excess profits and any deficiencies or losses arising in any such accounting period, and the total excess rent for any such accounting year, shall be apportioned between the time up to, and the time after, that date in proportion to the number of months or fractions of months before and after that date respectively.

51. *Interpretation.*—In this Part of this Act references to the principal Act, or to any provisions of that Act, shall be construed as references to that Act, or those provisions as amended and extended by any subsequent enactment.

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APPENDIX C

TEXT OF FINANCE ACT, 1920, RELATING TO CORPORATION PROFITS TAX

(10 & 11 Geo. 5, ch. 18, 4th Aug., 1920)

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PART V

CORPORATION PROFITS TAX

52. *Charge of corporation profits tax.*—(1) Subject as provided in this Act, there shall be charged, levied and paid on all profits being profits to which this Part of this Act applies and which arise in an accounting period ending after the thirty-first day of December, nineteen hundred and nineteen, a duty (in this Act referred to as "corporation profits tax") of an amount equal to five per cent of those profits:

Provided that—

(*a*) where the profits are profits arising in an accounting period of twelve months, no tax shall be charged on the first five hundred pounds thereof, and where the profits are profits arising in some shorter accounting period, no tax shall be charged on such amount of the profits as bears to five hundred pounds the same proportion as the shorter accounting period bears to twelve months; and

(*b*) the amount of tax payable in respect of the profits of a British company for any accounting period shall in no case exceed the amount represented by ten per cent of the balance of the profits of that period estimated in accordance with the provisions of this Part of this Act, after deducting from the amount of those profits any interest or dividends actually paid out of those profits at a fixed rate on any debentures, debenture stock, preference shares (so far as the dividend paid thereon is at a fixed rate) or permanent loan issued before the commencement of this Act, or on any debentures, debenture stock, or permanent loan issued after that date for the purpose of replacing an equal amount of any debentures, debenture stock, or permanent loan issued after that date.

(2) The profits to which this Part of this Act applies are, subject as herinafter provided, the following, that is to say:—

(*a*) the profits of a British company carrying on any trade or business, or any undertaking of a similar character, including the holding of investments:

(*b*) the profits of a foreign company carrying on in the United Kingdom any trade or business, or any undertaking of a similar character, so far as those profits arise in the United Kingdom.

Provided that this Part of this Act shall not, during the period between the first day of January, nineteen hundred and twenty, and the

thirty-first day of December, nineteen hundred and twenty-two, apply to the profits of—

(i) a company which carries on wholly in the United Kingdom any gas, water, electricity, tramway, hydraulic power, dock, canal, or railway undertaking, and which by, or by virtue of, any Act is precluded either from charging any higher price, or from distributing any higher rate of dividend than that authorised by, or by virtue of, the Act; or

(ii) any company being a building society.

(3) In this Part of this Act—

The expression "company" means any body corporate so constituted that the liability of its members is limited, but does not include a company formed before the commencement of this Act whose assets consist wholly of stock or other securities issued by any public authority and formerly held by the persons by whom the company was formed:

The expression "British company" means any company incorporated by or under the laws of the United Kingdom:

The expression "foreign company" means any company which is not a British company:

The expression "permanent loan" means a loan of a permanent character which is secured by mortgage or debentures or otherwise on the assets or income of a company and which, if subject to repayment, is subject to repayment at not less than three months' notice.

53. *Determination of profits.*—(1) For the purpose of this Part of this Act profits shall be taken to be the actual profits arising in the accounting period, and shall not be computed by reference to the income tax year or on the average of any years.

(2) Subject to the provisions of this Act profits shall be the profits and gains determined on the same principles as those on which the profits and gains of a trade would be determined for the purposes of Schedule D, set out in the First Schedule to the Income Tax Act, 1918, as amended by any subsequent enactment, whether the profits are assessable to income tax under that Schedule or not:

Provided that for the purpose of this Part of this Act—

(*a*) profits shall include all profits and gains arising from any lands, tenements, or hereditaments forming part of the assets of a company, and all interest, dividends and other income arising from investments or any other source and received in the accounting period, not being interest, dividends or income received from a company liable to be assessed to corporation profits tax in respect thereof, and no deduction shall be allowed on account of the annual value of any premises used for the purposes of the company:

(*b*) deductions shall be allowed in respect of interest on money borrowed for the purposes of the company and for rent or royalties or share of profits distributed to employees under a

profit-sharing scheme, and of any other payment income tax on which is collected at the source, not being payments of dividends or payments for the distribution of profits, so, however, that no deduction shall be allowed in respect of royalties paid to or interest on money borrowed from, a person having a controlling interest in the company, whether directly or indirectly, or whether solely or jointly with other persons, or in respect of interest paid on permanent loans:

(*c*) any deduction allowed in respect of the remuneration of any director, manager or other person concerned in the management of a company, who has a controlling interest in the company, whether directly or indirectly, and whether solely or jointly with any other persons, shall not exceed an amount calculated at the rate of one thousand pounds per annum:

(*d*) no deduction shall be allowed in respect of any transaction or operation of any nature, which has artificially reduced the amount to be taken as the amount of the profits of the company for the purposes of this Part of this Act:

(*e*) no deduction on account of wear and tear or renewals or obsolescence or any expenditure of a capital nature for the development of the company or otherwise in respect thereof shall be allowed other than such as may be allowed under the enactments relating to income tax:

(*f*) no deduction shall be allowed on account of the liability to pay, or the payment of, income tax or corporation profits tax:

(*g*) a deduction shall be allowed on account of any excess profits duty payable or paid in the United Kingdom and for any sum payable or paid on account of excess profits duty or similar duty imposed in any country, outside the United Kingdom for the same accounting period, but in computing profits for the purposes of Excess Profits Duty in the United Kingdom no deduction shall be allowed on account of the liability to pay or the payment of tax under this Part of this Act:

(*h*) profits shall include in the case of mutual trading concerns the surplus arising from transactions with members, and in the case of a society registered under the Industrial and Provident Societies Act, 1893, (*56 & 57 Vict. c. 39*), any sums paid by way of bonus, discount or dividend on purchases, shall be treated as trade expenses, and a deduction shall accordingly be allowed in respect thereof:

(*i*) in the case of a company carrying on the business of life assurance the part of the profits belongnig or allocated to, reserved for or expended on behalf of policy holders or annuitants shall be apportioned between the profits of the company directly liable to assessment to corporation profits of the company directly liable to assessment to corporation profits tax and the profits not so liable, and a deduction shall

be allowed of the amount so apportioned to the profits so liable:

Where a company carries on life assurance business in conjunction with assurance business of any other class the life assurance business of the company shall, for the purposes of apportionment under this paragraph but for no other purpose, be treated as if it were a separate business carried on by a separate company:

(*j*) any sum received by way of repayment of excess profits duty in respect of a previous accounting period under subsection (3) of section thirty-eight of the Finance (No. 2) Act, 1915, and subsequent amendments thereof shall be excluded from the profits taxable:

(*k*) In the case of any contract extending beyond one accounting period from the date of its commencement to the completion thereof, and only partially performed in any accounting period, there shall (unless the Commissioners of Inland Revenue owing to any special circumstances otherwise direct) be attributed to each of the accounting periods in which such contract was partially performed such proportion of the entire profits or loss, or estimated profits or loss, in respect of the complete performance of the contract as shall be properly attributable to such accounting periods respectively, having regard to the extent to which the contract was performed in such periods.

(3) Where a company (hereinafter referred to as "the principal company") holds either in its own name or in that of a nominee the whole of the ordinary capital of any other company (hereinafter referred to as "the subsidiary company") or so much of that capital as under the general law can lawfully be held by a single shareholder, the profits of the subsidiary company shall, if an application in that behalf is made by the principal company, be treated for the purposes of this Part of this Act as being the profits of the principal company as if the subsidiary company were a branch of the principal company, and the subsidiary company shall not be separately assessed to tax under this Part of this Act:

Provided that in ascertaining, under paragraph (*b*) of subsection (1) of the last preceding section, the maximum amount of tax payable by the principal company, no deduction shall be allowed in respect of any payments made by the subsidiary company to the principal company, or any other company which in relation to the principal company is a subsidiary company within the meaning of this subsection.

54. *Determination of accounting period.*—(1) For the purposes of the tax under this Part of this Act the accounting period shall be a period of twelve months ending on the date up to which the accounts of the company are usually made up:

Provided that where the accounts of a company have been made up

for a period greater or less than twelve months, or where the accounts have not been made up or where the company has ceased to carry on business or has transferred its business or part of its business to some other person, the accounting period shall be such period not exceeding twelve months as the Commissioners of Inland Revenue may determine.

(2) In the case of a company which was in existence before the beginning of the first day of January, nineteen hundered and twenty, the first accounting period for the purpose of this Part of this Act shall be the first accounting period of the company which ends after that date:

Provided that where part of an accounting period is after and part before the beginning of the first day of January, nineteen hundred and twenty, the total profits of the accounting period shall be apportioned between the period up to and the period beginning on that date in proportion to the respective lengths of those periods, and corporation profits tax shall be charged only on so much of the profits as are apportioned to the period beginning on that date, and that period shall be deemed to be an accounting period for the purpose of this Part of this Act.

(3) The Commissioners of Inland Revenue may, if they think fit, divide any periods for which accounts have been made up, and may make such apportionments or aggregations of profits and losses as may be necessary for the purpose of estimating the profits or losses for the yearly accounting period, or for any other purpose of this Part of this Act.

Any apportionment under this subsection shall be made in proportion to the number of months or fractions of months in the respective periods representing the divided periods.

55. *Returns for purpose of Part V and penalty for fictitious transactions.*—(1) The Commissioners of Inland Revenue may, for the purposes of this Part of this Act, require the secretary of a company or other officer (by whatever name called) performing the duties of secretary of the company, or, in the case of a foreign company, any person being an agent, manager, factor, or representative (by whatsoever name called) of the company, to furnish them within two months after the requirement for the return is made with returns of the profits of the company during any accounting period and such other particulars in connection therewith as the Commissioners may require.

(2) Where the profits of any company are chargeable to corporation profits tax under this Part of this Act it shall be the duty of every person who may be required to make a return under this section to give notice that the profits are so chargeable to the Commissioners of Inland Revenue within six months of the end of the period for which the accounts of the company are made up, unless he has been previously required by the Commissioners to make a return under this section, and it shall be the duty of the liquidator of every

company which is being wound up at the time of the commencement of this Act or is wound up after the commencement of this Act, and is chargeable to corporation profits tax, to give notice of the fact to the Commissioners of Inland Revenue.

(3) If any person fails to furnish a proper return in accordance with the foregoing provisions of this section or to comply with any requirement of the Commissioners under this section, or to give any notice required by this section, he shall be liable on summary conviction to a fine not exceeding one hundred pounds and to a further fine not exceeding ten pounds a day for every day during which the offence continues after conviction therefor.

(4) A company shall not, for the purpose of avoiding the payment of corporation profits tax, enter into or carry out any fictitious or artificial transaction.

If any company acts in contravention of this provision, the company, and in the case of a foreign company the agent, manager, factor, or other representative of the company, shall be liable on summary conviction to a fine not exceeding five hundred pounds.

56. *Supplementary provisions as to corporation profits tax.*—(1) Corporation profits tax shall be assessed by the Commissioners of Inland Revenue and shall be payable on the expiration of two months from the date on which it is assessed.

(2) Where a company on whose profits the tax is to be assessed is a British company the tax shall be assessed on the company, and where the company on whose profits the tax is to be assessed is a foreign company the tax shall be assessed on the company in the name of any agent, manager, factor or other representative of the company.

(3) Where a company is in the course of being wound up, the liquidator, receiver or other person having the control of the assets of the company shall not distribute the same until provision has been made to the satisfaction of the Commissioners of Inland Revenue for the payment of any corporation profits tax for which the company may be liable.

Any liquidator, receiver or such other person as aforesaid who distributes the assets of the company without making such provision as aforesaid shall be liable to a fine not exceeding three times the amount of any corporation profits tax which may be payable.

(4) An assessment (including an additional assessment) may be made by the Commissioners of Inland Revenue at any time within six years after the end of the accounting period in respect of the profits on which the assessment is made, and in the absence of a satisfactory return or other information on which to make an assessment the Commissioners may make an assessment according to the best of their judgment.

(5) The amount of corporation profits tax payable shall be recoverable as a debt due to His Majesty from the company on which it is assessed, or in the case of a foreign company from the person in whose name the company is chargeable, and where the amount of tax

payable is less than fifty pounds the tax shall, without prejudice to any other remedy, be recoverable summarily as a civil debt.

(6) Any company which is dissatisfied with the amount of any assessment made upon it by the Commissioners of Inland Revenue under this Part of this Act may appeal to the Commissioners for the general purposes of income tax acting for the division in which the company is assessed for income tax or to the Commissioners for the special purposes of the Income Tax Acts, and those Commissioners shall have power on any appeal, if they think fit, to summon witnesses and examine them upon oath.

The power under section one hundred and ninety-six of the Income Tax Act, 1918, to require an appeal in Ireland to the Special Commissioners to be reheard by the county court judge, or chairman of quarter sessions, or recorder, shall apply to an appeal in Ireland under this provision.

Section one hundred and forty-nine of the Income Tax Act, 1918 (which relates to the statement of a case on a point of law), shall apply with the necessary modifications in the case of any appeal to the General or Special Commissioners under this section, or of the rehearing of any such appeal in Ireland, as it applies in the case of appeals to the General or Special Commissioners under the Income Tax Acts.

(7) The commissioners of Inland Revenue may make regulations with respect to the assessment and collection of the corporation profits tax and the hearing of appeals under this section, and may by those regulations apply and adapt any enactments relating to the assessment and collection of income tax, or the hearing of appeals as to income tax by the General or Special Commissioners, which do not otherwise apply.

(8) All Commissioners and other persons employed for any purpose in connection with the assessment or collection of corporation profits tax shall be subject to the same obligations as to secrecy with respect to corporation profits tax as those persons are subject to with respect to income tax, and any oath taken by any such person as to secrecy with respect to income tax shall be deemed to extend also to secrecy with respect to corporation profits tax.

APPENDIX D

Assessment of Insurance Companies Under the Excess Profits Duty

The following specific queries were submitted to the Board of Inland Revenue regarding the method of arriving at the tax liability of insurance companies under the British Excess Profits Duty:

"What is the method of computing the net income and invested capital of insurance companies, particularly mutual life insurance companies? If additions to reserves are allowable deductions, are the corresponding reserves treated as part of the invested capital, rather than as liabilities, for purposes of the Excess Profits Duty? In general, are reserves similar to the re-insurance or main policy reserve of a life insurance company treated as 'borrowed money' in computing invested capital? By 'invested capital' is meant the capital sum to which the percentage deduction is applied when that method of computing the principal deduction or credit under the Excess Profits Duty is employed."

The reply of the British officials, which appears in detail below, reveals (1) that mutual life insurance companies are not considered to be "carrying on business" within the scope of the Excess Profits Duty legislation: (2) that life insurance companies in general, although within the scope of the application of the law, have not made profits great enough to render them liable: and (3) that other types of insurance companies are taxed under interesting compromise plans evolved as the result of appeals to the Board of Referees:

"As regards fire, accident and general insurance companies (other than life and marine), the invested capital does not form the basis of the pre-war standard of profits that is to be allowed in calculating the excess. The companies applied under Section 42 of the Finance (No. 2) Act, 1915, for an altered basis on the ground that the capital employed in the business is small compared with the capital at stake. The Board of Referees ordered that the percentage laid down by the Act should be granted on the capital at stake, which they determined should be taken to be equivalent to one-half of the net premium income of the year at the end whereof capital is to be reckoned.

"In these cases the net income corresponds roughly with the net profit shown by the accounts, except that income from invested capital is excluded. Any increase or decrease in reserve for unexpired risks, or for claims received but not adjusted, is taken into account; but no allowance is made for reserves for other purposes, or for a general reserve.

"As regards marine insurance companies, the percentage is also applied to the capital at stake and not to the invested capital. The capital at stake is (by virtue of an order of the Board of Referees) to be taken as the equivalent of the net premium income of the year at the end whereof capital is to be reckoned.

"The net income corresponds roughly with the net profits shown by

the accounts, except that income from invested capital is excluded. Ordinarily the account of a particular year is not closed until two years after its termination. In practice provisional assessments are made, and are adjusted when the account has been completed. Any necessary reserve for outstanding claims at the close of the account is allowed, but no allowance is made for other reserves or for a general reserve.

"As regards life insurance companies, the question of a liability in respect of excess profits has not been found to arise. Under the British income tax acts, a life insurance company is chargeable to income tax on the interest on its investments (less the expenses of management, including commissions), or on the amount of its profits (including amounts allotted to policy holders),—whichever is the greater. If the same basis of computing income were adopted for excess profits duty, and capital were taken to be the whole funds including the investments, it is obvious that the income would not be likely to exceed 6 per cent of the capital, in view of the nature of the investments of a like office. On the other hand, if, for Excess Profits Duty purposes, only the profits credited to the account of the shareholders and only the capital of the shareholders were to be considered, although those profits might often exceed 6 per cent of that capital, it would be very unusual, owing to war mortality and depreciation of investments, to find that the profits credited to shareholders' account exceeded the profits so credited in the pre-war standard years, which in the case of the British Excess Profits Duty can always be adopted for standard purposes, instead of the percentage on capital, which is merely an alternative standard granted in the interests of the taxpayer in cases where the pre-war profits were very low.

"It will be appreciated from the above, that the question of an Excess Profits Duty calculation for life assurance companies has only arisen in connection with a *deficit* below the pre-war standard of profits, in the case of composite companies carrying on life business, together with fire, marine, accident or general business, in which latter classes of business there have been excess profits against which it is desired to set off the deficit in the life business. This point has arisen lately, and . . . the method of computation has not been finally arranged. . . .

"Mutual Life Insurance Companies are not regarded as carrying on the businesses within the scope of the Excess Profits Duty legislation.

"Under the Excess Profits Duty rules, any borrowed money or *debts* fail to be deducted in computing capital. Although the point has not arisen in a form that has necessitated a decision, it is considered that the reserve made by the actuary as representing the liability to policy holders could not be held to be borrowed money, but that it could be held to be a debt, inasmuch as the policy holders have a vested interest.

"It is considered that, if under the British Excess Profits Duty

law it became necessary to calculate the capital of a proprietary life insurance company, it should be computed by taking the amount of the Balance Sheet Assets, and deducting therefrom the Balance Sheet Liabilities exclusive of the shareholders' capital, but including the whole of the Life Assurance Fund, and any reserve funds so far as they are held for the exclusive benefit of policy holders. It is believed that this would give a fair measure of the shareholders' capital in the business, except that in some cases a fraction of the undivided surplus of the life fund might be held to appertain to the shareholders. The general result would often be that that capital so calculated would be relatively small, and it might result in application being made to the Board of Referees to substitute capital at stake for capital invested, wherever, as happens in most cases, there is considerable uncalled capital. The strain on capital in the case of most life insurance companies is, of course, very small, and it is not anticipated that if such an application were made, the decision would be anything like so favorable to the companies as in the case of the application by fire, accident and general companies. As, however, ... any question is only likely to arise in claims to set off a deficit in a life assurance business against an excess in another business, and as the allowance of such a claim does not rest on statutory authority but on administrative concession, it is not anticipated that there will be difficulty in gaining acceptance of a method that provides substantial justice."

APPENDIX E

Select List of Manuals on Excess Profits Duty

Langdon, A. M. *The Excess Profits Duty and Excess Mineral Rights Duty.* (Stephens and Haynes, Bell Yard, Temple Bar, London.)

Murray and Carter. *A Guide to Income Tax Practice and Excess Profits Duty.* Eighth Edition. (Gee and Co., 34 Moorgate Street, London, E. C. 2.)

Piper, J. E. *Finance Acts of 1915 with notes. Supplement to Dowell's Income Tax.* (Butterworth and Co., Bell Yard, Temple Bar, London.)

Sanders, William. *Law and Practice of Excess Profits Duty.* (Gee and Co., 34 Moorgate Street, London, E. C. 2.)

Snelling, W. E. *Excess Profits Duty, including Excess Mineral Rights Duty and Munitions Levies.* (Sir Isaac Pitman, 1 Amen Corner, London, E. C.)

Spicer and Pegler. *Excess Profits Duty and Profits of Controlled Establishments.* (Foulks, Lynch and Co., 61 Watling Street, London, E. C. 4.)

Underhay, F. G. *Income Tax, including Excess Profits Duty.* (Ward, Lock and Co., London.)

APPENDIX F

Opinion Given by the Committee of Consulting Accountants on Stock Valuations for Munitions Levy and Excess Profits Duty Purposes

We have considered the proposal[1] made by the Association of Conl trolled Owners to the Inland Revenue Department at the meeting of June 8th, 1917, for the basis to be adopted in the valuation of stocks on hand, which is set forth in the attached statement.

These proposals would—

(*a*) deprive the Treasury of a considerable sum which it would otherwise receive either under Munitions Levy or under Excess Profits Duty, and

(*b*) leave the owners with stocks at the end of the last accounting period considerably below market values prevailing or likely to prevail for many years after that date.

We consider that there is only one sound general principle of valuing stocks for the purposes of these Acts, and that is:—

That all stocks of every sort or kind should be valued at the end of each accounting period on the basis of cost price or market value, *whichever is the lower.* This principle rests upon the theory (which is perfectly sound) that profits can only be realised by the sale of commodities and that no profits can arise by mere increase of value unaccompanied by a sale. To follow this out consistently, stocks therefore should be carried at their cost price until they are sold and the profit is ascertained. Where, however, the market price is lower than the cost, a precautionary reserve is permissible for the difference between the cost and the market value.

We are of opinion that this principle should be adopted throughout in determining profits, whether for the purposes of Munitions Levy or Excess Profits Duty, with, however, the following qualification:—

In certain base-metal manufacturing trades, such as copper, pig iron, lead, spelter, &c., it has been the custom for a long period in the past to adopt what is known as a "base value" for part of these materials, on the theory that it is necessary for the undertakings using

[1] This proposal was in the following terms:—

The valuation of all stocks of materials and stores and of manufactured or partly manufactured products shall be dealt with at the end of each accounting period and at the end of control as follows:—

(*a*) An amount in weight or quantity, equivalent to the weight or quantity of the stocks at the beginning of the first accounting year shall be valued at the same prices as at the beginning of the first accounting year.

(*b*) Any surplus shall be valued at cost price, provided that firms shall be entitled to realise such surplus over a period of one year from the date that control ends, the loss, if any, being defrayed from excess profits.

(*c*) Where there is a deficiency of stocks, a firm shall be entitled to a replacement or an equivalent allowance.

(*d*) Purchase contracts so far as existing at the beginning of the first accounting period shall, to the extent of any deliveries thereunder during control, be reckoned as stock at the beginning of the first accounting period.

them to keep a reserve stock to protect themselves against results of strikes and adverse fluctuations in market value, &c., and for this purpose they have adopted a value which represents what may be called a minimum cost over a series of years for a minimum quantity; in theory, keeping this minimum quantity untouched and unused, although in practice no actual reserve stock may be kept which could be identified at any time; any excess over this amount is valued at cost or market value, whichever is the lower.

It appears to have been the practice of the Inland Revenue to admit for Income Tax purposes stock valuations of this character in the case of base metals, provided that it is the general custom of the particular trade, and has also been the practice in the individual case, and it will be difficult now to disturb this practice. The conditions, however, during the war period are so abnormal, and the effect upon Excess Profits Duty and Munitions Levy of this practice is so important, that a modification thereof would seem to be necessary. The prices of these base metals have risen continuously and to levels which have hardly been known in the past. If an owner adopting this method of valuation is allowed to continue it throughout the period to which Excess Profits Duty applies, he will, in effect, be making an increasingly large reserve during each year of rising prices to the extent of the increase in the cost price of the base stock which may have been used and replaced during that year, and will as a result pay considerably less Excess Profits Duty than would be paid by an exactly similar concern which values its stocks on the usual basis of cost or market.

We think that in cases where base stock valuations are accepted, the same reserve (*i.e.*, amount sterling) should be permitted at the close of the last period of assessment as at the beginning of the first period of assessment, viz., an amount equivalent to the margin between the base price and the market price on the minimum quantity at the beginning of the first period of assessment. In effect this will mean that those concerns in which the base price has been admitted in the past will, during the accounting period, be put back on to a cost or market price basis, and will be on a par with other concerns which have throughout valued on that basis. If this principle be adopted the Association's claim under (*c*) does not arise, and any possible hardship to the owner is met by the recommendation made later in respect of losses made on realisation of stocks after the end of the last period of assessment.

In an exceptional instance, when it can be proved that a specific quantity of metals has been lying in stock untouched throughout the period of control, we do not consider that the owner's claim to take this same parcel out of control at the price at which it was brought in can successfully be resisted; because, if the theory we have stated is accepted, profits can only be realised by the sale of commodities and no profits can arise by a mere increase in value unaccompanied by a sale.

The claim of the owners for consideration in respect of stock values

arises from their fear (which is probably to some extent justified) that they may be left at the end of the last accounting period with stocks at excessively high prices and perhaps in excessive quantities, and that after the war ends prices may fall rapidly, and they may consequently lose a good deal of money on the conversion and sale of these stocks.

There is no doubt some force in this contention, and it seems only reasonable that, if the Government have taken from the owners a large share of their profits when they were purchasing on a rising market, the owners should not be left the whole of the loss when the natural reaction comes and they are selling on a falling market. If the Excess Profits Duty period extends for not less than twelve months after the end of the war, it may be expected that these difficulties will have adjusted themselves within this period; that by that time prices will have found a general "after-the-war" level, and that the excessive quantities, if any, will have been worked off.

To meet this contention, we would strongly recommend that an undertaking should be given to the manufacturers that if the Excess Profits Duty should be repealed within a few months of the end of the war, fair compensation will be given for any loss they can prove to have arisen during the succeeding twelve months by the realisation of these stocks either in their raw or manufactured condition.

The final claim (*d*) made by the Association of Controlled Owners does not arise if their first claim (*a*) is not conceded. If the stock be valued at cost, it is immaterial whether goods bought "forward" at the beginning of control are treated as stock-in-hand at that date or as purchases when delivery takes place. We submit, however, that on general grounds this claim is unsound. In most manufacturing businesses contracts for future delivery of necessary materials are made, as a common practice, to ensure that the quantities required are received as and when they are wanted. If all manufacturers who enter into such contracts were to demand delivery on the day on which the contract was made, no one would receive more than a small quota of his contract, because sufficient materials to meet all the contracts would not be in existence in a state in which they could be delivered. Sellers, as well as buyers, make their contracts ahead to ensure delivery of their products as required, and they cannot in a general way deliver them at any earlier dates; consequently, there seems no reason to discriminate between purchases made under long-dated contracts and those made from "hand to mouth," but that both should be taken into account as and when received on the general principle indicated above—namely, cost or market, whichever is the lower.

Signed by the following Chartered Accountants,

A. Lowes Dickinson (Price, Waterhouse & Co.).
F. L. Fisher (Fuller, Wise, Kirby & Fisher).
F. N. Keen (W. B. Keen & Co.).
L. Maltby (Deloitte, Plender, Griffiths & Co.).
R. H. Stainforth (Gray, Stainforth, Newton & Co.).

Ministry of Munitions,
28, Northumberland Avenue, W.C. 2.
14th June, 1917.